Calendar No. 638

99TH CONGRESS
2d Session

SENATE

REPORT
99-292

AMENDING TITLE 10, UNITED STATES CODE, TO ESTABLISH A REVISED RETIREMENT SYSTEM FOR NEW MEMBERS OF THE UNIFORMED SERVICES, TO REVISE THE METHOD OF DETERMINING COST OF LIVING ADJUSTMENTS UNDER THE REVISED RETIREMENT SYSTEM, AND FOR OTHER PURPOSES

MAY 1 (legislative day, APRIL 28) 1986.—Ordered to be printed

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Mr. GOLDWATER, from the Committee on Armed Services, submitted the following

REPORT

[To accompany S. 2395]

The Committee on Armed Services reports favorably an original bill to amend title 10, United States Code, to establish a revised retirement system for new members of the uniformed services, to revise the method for determining cost of living adjustments under the revised retirement system, and for other purposes, and recommends that the bill do pass.

PURPOSE OF THE BILL

The purpose of this bill is to revise the nondisability retirement system for the uniformed services for individuals who become members of a uniformed service for the first time after the date of enactment.

SUMMARY OF THE BILL

This bill would substantially revise the current nondisability retirement system for members of the uniformed services. All of the changes made by the bill would be prospective, and would apply only to those individuals entering military service after the date of enactment.

The major provisions of this bill would:

1. Retain the existing "High-3" base for military retired pay that has been in effect for all individuals entering service since September 8, 1980, in which the retired pay base is equal to the average of the highest 36 months of basic pay;

2. Revise the current multipliers for determining military retired pay from the current 2.5 percent per year of service to 2.2

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per cent per year for years 1-20 and 3.1 per cent per year for years after 20, up to a maximum of 75% of the retired pay base; and

3. Modify the current Cost of Living Allowance (COLA) formula for uniformed services retirement for nondisability retirees to provide an annual COLA of the percentage increase in the Consumer Price Index minus one percentage point (CPI-1) for life with a one-time restoral at the 40th anniversary of service, while retaining the current full CPI COLA protection for disability retirees and survivors.

Background

CURRENT MILITARY RETIREMENT SYSTEM

Today, military retired pay is calculated on the basis of the active duty basic pay of the highest grade held times 2.5 per cent for each year of service. There is no retirement vesting prior to the 20 years of service point. At that time, a military member becomes eligible to receive 50% of his basic pay for life, rising 2.5 percentage points for each year of service to the maximum of 75% of basic pay for 30 years of service or more.

Prior to 1980, military retired pay was calculated on the basis of the basic pay of the military member on the day of retirement. Due to a change enacted in 1980 (P.L. 96-342), military retired pay will be calculated on the basis of the average high-3 years of basic pay for individuals entering military service after September 8, 1980. This change is estimated by the Department of Defense (DoD) to have reduced the future costs of military retirement by 12%. The Congressional Budget Office (CBO) estimates the reduction at 8.4%.

Military retirees receive one cost of living adjustment (COLA) each year, which under current law must be equal to the annual COLA for Federal civilian retirees provided under section 8340(b) of title 5, United States Code. Under a change enacted in 1984, the COLA adjustment equals the percentage increase in the average of the consumer price indices for July, August, and September over the averaged indices for the same three months of the prior year. These increases become effective for entitlements earned in December, and are paid on January 1.

The last military retired pay COLA was 3.5% effective in December, 1984, and first paid on January 1, 1985. The 3.1% COLA scheduled to go in effect for December, 1985, on January 1, 1986, was canceled by the Gramm-Rudman-Hollings legislation (P.L. 99-177).

Military retirement is a non-contributory system. However, while on active duty military members contribute to the Social Security system and thereby earn social security retirement benefits. The receipt of military retired pay has no effect on Social Security benefits, nor does receipt of Social Security have any effect on military retirement benefits.

The average (mean) nondisability retirement ages are 42 for enlisted members (after 22 years of service) and 46 for officers (after 25 years of service). The most common (median) retirement age is 44 for officers and 41 for enlisted personnel. Over one-third of all retirees leave active duty upon completing 20 years of service.

Officers account for one-third of the number of military retirees (1.4 million as of FY1985) but one-half of the total costs of military retirement.

The following table summarizes the monthly and annual retired pay for a typical enlisted retiree (E–7 with 22 years of service) and officer retiree (O–5 with 23 years of service) under the current terminal basic pay and the High-3 method of calculating military retired pay.

EXAMPLES OF MONTHLY AND ANNUAL MILITARY RETIRED PAY

	Retired pay			
	E–7 W/22 YOS		O–5 W/23 YOS	
	Monthly	Annual	Monthly	Annual
Terminal basic pay	$970	$11,640	$2,092	$25,104
High-3 (for those entering after Sept. 30, 1980)	888	10,656	1,916	22,992

In reviewing the military retirement system, the Committee believes it is important to note that this system serves a dual purpose. It is an integral part of the military compensation package, and as such it must serve as a retention incentive sufficient to encourage people to stay in military service for at least 20 years. But the military retirement system is also an important force management tool. Through retirement and separation, the military services keep the age, skill and experience levels of their forces in balance with the force profile necessary for them to carry out their national defense mission.

BUDGETING FOR MILITARY RETIREMENT

Beginning with FY1985, budgeting for military retirement was changed from an annual "pay-as-you-go" basis to an accrual system. DoD currently pays into the Military Retirement Trust Fund a percentage of its military payroll (approximately 51% of basic pay) sufficient to pay for the retirement benefits earned in that year but to be paid in the future. Actual payments to military retirees are paid out of the Military Retirement Trust Fund, which is overseen by an independent Board of Actuaries and which is not included in the annual Defense Budget.

The FY1986 budget included $18.2 billion for the accrual costs of military retirement for future retirees. Estimated outlays for military retirement for current retirees from the Military Retirement Trust Fund in FY1986 are $17.8 billion.

CRITICISM OF THE MILITARY RETIREMENT SYSTEM

There have been two major criticisms of the military retirement system over the years.

The first criticism is that the system as a whole is too expensive. Critics argue that, particularly with the increases in military compensation under the All-Volunteer Force, military retirement benefits are higher than necessary to retain military members in sufficient numbers to man the career forces of the military services. These critics also argue that bonuses and special pays, targeted to

certain critical skills, are a more cost-effective retention tool than across-the-board retirement benefits.

The second criticism is that the current retirement system provides a large incentive for military members to retire at 20 years of service, and does not provide sufficient incentive to encourage military members to stay in service for longer careers.

There are arguments to counter these criticisms. For a number of years, military retirement has been described as deferred compensation for the unique hardships of military life. Additionally, military retirees remain subject to recall to active duty. Finally, the military manpower management system is based on the need for a youthful and vigorous force and therefore must continue to have a mechanism like the 20-year retirement to keep the force from becoming too old or too stagnant.

After hearing all sides of this argument, the Committee has concluded that the overall future costs of the military retirement can be reduced without significant adverse impact on the Services' career force while still providing fair and equitable retirement benefits for military members.

CONGRESSIONAL ACTION IN THE DEPARTMENT OF DEFENSE AUTHORIZATION ACT, 1986 (P.L. 99-145) AND IN THE DEPARTMENT OF DEFENSE APPROPRIATIONS ACT, 1986 (P.L. 99-190)

For a number of years, the Defense Department and the individual military services have opposed any changes to the military retirement system. Despite growing Congressional concern over the costs of military retirement and the need to reform the current system, the Defense Department has not voluntarily submitted a comprehensive legislative proposal to reform the military retirement system since 1979.

Last year, in the Department of Defense Authorization Act, 1986, Congress took steps designed to require the Defense Department to submit to Congress legislative proposals to change the military retirement system.

Section 666 of the Department of Defense Authorization Act, 1986, placed a ceiling on the total amount of dollars that could be obligated from the military personnel appropriation accounts in each service for basic pay and retirement accrual costs in FY1986. This ceiling on obligations was $2.9 billion, or 16%, below the level required by present retirement entitlements, basic pay rates, and force size requested in the FY1986 Defense budget for military basic pay and costs. Under current permanent law, DoD *must* pay into the Military Retirement Trust Fund each year the percentage of military basic pay sufficient to pay for the future retirement benefits of the force earned that year. In order to live within this obligation ceiling in FY1986, DoD must either make large reductions in the size of the current military force or Congress must reduce the FY1986 military retirement accrual charge by changing the current military retirement entitlement for future retirees.

Section 667 of the Department of Defense Authorization Act, 1986, required the Secretary of Defense to submit to the Congress two legislative proposals to change the military retirement system which, if effective on October 1, 1985, would achieve the required

$2.9 billion in savings. Section 667 required that one of these proposals could not obtain savings by changes to the current cost of living allowance (COLA) adjustment mechanism for military retirement. This section also required the Secretary of Defense to report on the recruiting and retention impact of reductions in military retirement accrual costs ranging from $1.8 billion to $5.4 billion in FY1986, including the $2.9 billion options in the actual legislative proposal.

In addition to Sections 666 and 667 of the Department of Defense Authorization Act, 1986, the Department of Defense Appropriations Act, 1986 (P.L. 99-190) included a provision dealing with FY1986 military retirement accrual costs that could have a serious impact on Defense Department manpower management if Congress does not complete action on this legislation by May 1, 1986.

Section 8103 of this Act provided that after May 1, 1986, obligations from the FY1986 military personnel appropriation accounts shall not exceed a rate in excess of the rate required to limit total obligations to the obligation ceilings established in the Department of Defense Authorization Act, 1986 for FY1986. In the absence of enactment of legislation reducing future military retirement accrual costs by May 1, 1986, Section 8103 would have required the Defense Department to begin reducing the military strengths of the services by several hundred thousand personnel in order to live within the current obligation ceilings on the FY1986 military personnel appropriation accounts.

To avoid a military manpower crisis in the Defense Department, on the same day it ordered reported the bill which this report accompanies, the Committee ordered reported a separate, free-standing bill extending the May 1 deadline in Section 8103 of the Department of Defense Appropriations Act, 1986 for one month to June 1, 1986. This measure was attached to H.J. Res. 220, which passed the Senate on April 23, 1986, and was agreed to by the House on April 29, 1986.

Defense Department Proposals

The Defense Department submitted the report required by Section 667 of the Department of Defense Authorization Act, 1986, to the Congress on November 15, 1985. This report included two legislative proposals that would change the military non-disability retirement system. Each of these proposals would have resulted in a reduction in military retirement accrual funding of $2.9 billion if they had been enacted into law by October 1, 1985.

In transmitting DoD's *Report to the Congress on Options to Reduce Military Retirement Accrual Funding in Fiscal Year 1986*, Secretary of Defense Caspar Weinberger indicated that the Defense Department was opposed to any changes to the current military retirement system. The Department's Report, including Secretary Weinberger's Letter of Transmittal, is printed in full under the section Departmental Views elsewhere in this report.

In developing the two legislative proposals to achieve the $2.9 billion in savings, the Defense Department was guided by the following major considerations (quoted in full from page 2-2 of the DoD Report):

Any revision to the military retirement system will apply only to those entering after the enactment of the revision.

The services must maintain a youthful and vigorous force relative to the labor force of society as a whole or the civil service labor force for that matter.

The initial retirement eligibility point of 20 years of service should be maintained both to provide the youthful and vigorous force and to provide the necessary career incentive for those serving in the relatively greater arduous duty locations.

The multipliers (percent of basic pay per year of service) are the most visible aspects of any revision.

The revision should provide an incentive for all to serve 20 years of service, yet encourage members to remain on active duty past 20 years of service.

The requirements of a youthful and vigorous force as implemented by the Defense Officer Personnel Management Act and Service Policies result in the forced retirement of service members from the military. Thus, the duration of retirement from the military is longer, and without restoral a reduced COLA would unduly lower the real value of retired pay in old age.

The Committee agrees with these considerations outlined by the Department of Defense, and has used them as the basis for its review of changes to the military retirement system.

One of the two proposals contained in the DoD report, hereafter referred to as the *Structural Change*, is composed of a change to the retired pay base and to the multipliers.

Under this option, the base for computing a member's retired pay would be the average basic pay of the military member's highest five years of pay (High-5), compared to the current highest three years (High-3) for members who entered service after September 8, 1980.

The multipliers under the Structural Change would be 2.15 percent for each year of service up to 20, and 3.2 percent for each year of service between 20 and 30. These multipliers would provide 43 percent of the High-5 retired pay base at 20 years of service, rising to the current 75 percent of the retired pay base at 30 years of service.

This option retains the full CPI annual COLA for military retirement benefits provided under current law.

The second DoD proposal, hereafter referred to as the *Combination Change*, included changes in the multipliers and in the current COLA formula.

Under this option, the retired pay base would remain the average highest 3 years of basic pay (High-3) already in effect for military members who entered service after September 8, 1980. The multipliers under this option would be 2.2 percent for each year of service up to 20 and 3.1 percent for each year of service between 20 and 30. These multipliers would provide 44 percent of the High-3 retired pay base at 20 years of service, rising to a maximum of 75 percent at 30 years of service.

The COLA under the Combination Change would provide an annual increase of one percentage point below the change in the CPI (CPI–1) until the 40th anniversary of service, generally age 58 to 62. At this 40th anniversary of service, the monthly payment

would be restored to what it would have been under a full CPI COLA from the time of retirement. After this one-time restoral, the annual COLA would continue to provide an annual increase of one percentage point below the change in the CPI.

ANALYSIS OF DOD OPTIONS

The Structural Change, because of its High-5 feature, would reduce military retired pay at the time of retirement to a lower level than the Combination Change. However, the Structural Change would protect the member's retired pay benefit from further erosion by providing full CPI COLA's each year.

The Combination Change provides a higher level of retired pay than the Structural Change at the time of retirement but provides less than full inflation protection. The one-time restoral at the 40th anniversary of service is an important feature of this option because it restores the purchasing power of the retired pay benefit at approximately the time the retired military member reaches normal retirement age.

Both of these proposals would provide approximately the same level of retired pay earnings over the lifetime of an average retiree. Either would have saved the $2.9 billion in FY1986 military retirement accrual costs (on an annual basis) required by the FY1986 Defense Authorization Act, if they had been enacted by October 1, 1985.

These two proposals would have approximately the same force manning impact on the military services. The CBO calculates that the Structural Change would reduce the size of the career force by 3.0 percent, while the Combination Change would reduce the career force by 2.4 percent. The Structural Change would reduce the average years of experience in the career force by 1.8 percent, or .21 years, while the Combination Change would reduce the average years of experience of the career force by .8 percent, or .1 year. However, a word of caution is in order on these (and any other) force manning impact figures.

Both CBO and DoD attempt to measure the impact of changes to the retirement system by calculating how military personnel would react to changes in retirement income. These projections of the impact of different levels of reduction in military retired pay on force manning are highly sensitive to discount rates which represent the individual's preference of pay over time, and to continuation or reenlistment rates which incorporate the effect changes in benefits have on retention.

The Committee examined the methodology used by CBO and DoD to predict the impact of changes in the retirement system on recruiting and retention in its hearings on these proposals. There is no doubt that a significant change in retirement income could substantially alter the attractiveness of a military career. But the fact is, as the DoD Report notes, that "No one knows what the continuation rates will be after a major change in retirement." The lack of prior experience with changes to the military retirement system and the vagaries of the model used to predict the impact of such changes make firm conclusions very difficult.

For example, the Manpower and Personnel Subcommittee hearings on these proposals demonstrated that the model used by DoD to predict retention changes caused by changes in the military retirement system assumes people value income received today more than income deferred to some point in the future. Consequently, this model suggests then an increase of several hundred million dollars in reenlistment or continuation bonuses paid to the career force could offset the negative retention impact of a reduction of several billion dollars in military retirement benefits.

It is important to bear these caveats in mind when considering the impact ot changes in the military retirement system on recruiting and retention.

All of the Department of Defense witnesses who testified before the Manpower and Personnel Subcommittee on the subject of military retirement reform were opposed to any change to the current system. However, all of the DoD witnesses also indicated that, if Congress was going to adopt one or the other of these two proposals, then they preferred the Combination Change to the Structural Change.

Committee Recommendation

The Committee's review of military retirement began with two days of hearings on the Defense Department's *Report to the Congress on Options to Reduce Military Retirement Accrual Funding in Fiscal Year 1986.* During these hearings, the Committee heard testimony from witnesses from the Department of Defense and from each of the military services. The Committee also heard testimony from witnesses from the General Accounting Office and from the Congressional Budget Office.

Following these hearings, the Committee conducted a thorough analysis of the two legislative proposals to change the military retirement system submitted by the Defense Department. The Committee also reviewed the major studies of the military retirement system conducted over the last fifteen years. This lengthy and careful review forms the basis for the Committee's recommendation to reform the military retirement system.

The Committee recommends adoption of the Combination Change to the military retirement system included in the Defense Department's Report to the Congress. For individuals who first enter military service after the date of enactment of this change, this proposal would provide 44% of the retired pay base (High-3) at 20 years of service instead of the current 50%, rising to the same 75% at 30 years of service that is available today. Instead of an annual full CPI COLA, this proposal would provide an annual COLA of CPI minus one percentage point until the retiree's 40th anniversary of service. At that point the monthly payment would be restored to what it would have been under a full CPI COLA from the time of retirement, with an annual COLA of CPI less one percentage point thereafter.

These changes would apply only to nondisability active duty and reserve retirement benefits. The Combination Change has the effect of reducing the multipliers for reserve retirement proportional to the reductions proposed for active duty retirees. In addition,

the changes in the COLA mechanism would apply to active duty and reserve retirement benefits. However, disability retirement benefits would not change from current law under the Combination Change. Also, in light of the extensive changes to the Survivor Benefit Plan adopted last year in the Defense Authorization Act, 1986, the Committee has modified the DoD Combination Change so that the contribution to and the annuity from the Survivor Benefit Plan will continue to be based on the current military retirement system, i.e., the laws in effect on the day before enactment of the changes. The Committee will continue to review the Survivor Benefit Program for those coming under the revised retirement system to determine if changes to the plan are needed in the future.

The Committee believes that its recommended changes achieve a reasonable and appropriate level of savings in future military retirement costs through a balanced combination of reductions to the retired pay multipliers and to the current COLA mechanism. These changes do not cut as deeply into the base of military retired pay while unrealistically leaving the full annual CPI COLA intact as did the Structural Change included in the DoD Report.

The change recommended by the Committee will encourage military members to stay in service beyond the 20 year point by "steepening the slope" of military retirement benefits between 20 and 30 years of service. However, this change does not reduce the 20 year benefit to the point that it is no longer a meaningful and equitable benefit for the more arduous enlisted skills and ratings.

Finally, as noted earlier, all of the Defense Department witnesses indicated that if Congress is going to enact legislation reforming the military retirement system, they would prefer the Combination Change included in the November, 1985, DoD Report to the Congress.

The military retirement system will continue to be both an integral part of the military compensation package and an important force management tool for the military services. The Committee believes that the changes recommended to the military retirement system will allow the Nation to continue to properly man our military services; will provide an equitable retirement benefit for military members; and will significantly reduce the future costs of the military retirement system.

The military retirement system has been the subject of debate for a number of years. The continuing uncertainty about the future of military retirement benefits has undermined morale in the Armed Forces, led many of our fine young men and women in uniform to pursue careers elsewhere, and created an atmosphere of distrust for the Congress by our service personnel. It may well be that this uncertainty has had more adverse effects on retention in the Armed Forces than will the changes to military retirement now recommended by the Committee. In making this recommendation, the Committee intends to end the long debate over the appropriate level of benefits provided under the military retirement system.

SECTION-BY-SECTION ANALYSIS

Section 1 of the bill provides that it may be referred to as the Uniformed Services Retirement Cost Reduction Act of 1986. That section also provides that, except as otherwise expressly provided, any amendment to or repeal of a section or provision shall be considered to be made to a section or provision of title 10, United States Code.

Section 2 of the bill amends subtitle A of title 10, United States Code, by amending sections 1331 (relating to retirement for nonregular service), 1401 (relating to computation of retired pay), 1402a (relating to recomputation of retired pay or retainer pay to reflect later active duty), 1403 (relating to tax treatment of disability retired pay), 1405 (relating to computing years of service), and 1407 (relating to the retired pay base), and adding a new section 1407a (relating to the retired pay multiplier) to reflect the adoption of a new method of computing non-disability retired pay for members of the armed forces who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Subsection (a) of section 2 of the bill amends section 1401 (relating to computation of retired pay).

Clause (A) of section 2(a)(1) of the bill redesignates the existing text of section 1401 as subsection (a) of section 1401.

Clause (B) of section 2(a)(1) of the bill amends the redesignated subsection (a) by inserting "who first became a member of a uniformed service (as defined in section 1407(a)(2) of this title) before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, or who is retired for disability under chapter 61 of this title" after "subtitle". This change would limit the computation of retired or retainer pay under section 1401(a) and its table to a person who first became a member of a uniformed service before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. The existing formula that authorizes 2½ percent for each year of service as a multiplier is preserved for such persons. Similarly, no change is made to the formula for computing the retired pay of a member retired for disability under chapter 61 of title 10 regardless of the date such member became a member of a uniformed service.

Paragraph (2) of section 2(a) of the bill adds a new subsection 1401(b) with a table to reflect a new formula for computing the non-disability retired pay or retainer pay of a person who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under the new formula the percentage factor as prescribed by new section 1407a (retired pay multiplier for members who first became members on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986), added by subsection (g) of section 2 of the bill, would be used to compute retired pay or retainer pay.

Subsection (b) of section 2 of the bill amends section 1402a (relating to recomputation of retired or retainer pay to reflect later active duty).

Paragraph (1) of section 2(b) of the bill redesignates the text of existing section 1402a(a) as section 1402a(a)(1).

Paragraph (2) of section 2(b) of the bill amends the redesignated section 1402a(a)(1) to preserve the formula for the recomputation of retired or retainer pay for members who first became members of a uniformed service (as defined in section 1407(a)(2)) after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. That formula provides that in calculating retired or retainer pay to reflect later active duty, the member's monthly retired or retainer pay base would be multiplied by 2½ percent of the sum of the years of service credited to him in computing retired or retainer pay plus his years of active service performed after becoming entitled to retired or retainer pay.

Paragraph (3) of section 2(b) of the bill adds a new paragraph (2) to section 1402a(a) to provide a new formula for the recomputation of retired or retainer pay of persons who first became members of a uniformed service (as defined in section 1407(a)(2)) on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under the new formula the percentage factor (multiplier) prescribed by new section 1407a, as added by section 2(f) of the bill, would be used to recompute the retired or retainer pay in lieu of the existing system of multiplying 2½ percent times the years of service the member has to his credit in recomputing such pay.

Subsection (c) of section 2 of the bill amends section 1403 (relating to tax treatment of disability retired pay) by inserting "(a)" after "1401" to reflect the redesignation of the existing text of section 1401 as subsection (a).

Subsection (d) of section 2 of the bill contains several amendments to section 1405 (relating to years of service) which add new section references made necessary by the redesignation of the existing text of sections 1401, 3991, 3992, 8991 and 8992 as, in each case, subsection (a), and the addition to each of these sections of a new subsection (b).

Subsection (e)(1) of section 2 of the bill adds a new definition to existing section 1407(a)(2) of title 10. The existing text of section 1407(a)(2) is rewritten to incorporate the new definition. The new definition makes clear when a member "first became a member of a uniformed service" for the purpose of determining the retirement rules under which the member is eligible to receive retired pay. The definition provides that a person first becomes a member of a uniformed service on the date he is first enlisted or was appointed in a uniformed service as an officer, an enlisted member, a cadet, or a midshipman, as the case may be. Although the taking of the oath at the time of initial enlistment or appointment often is not coincident with active duty service, entitlement to pay or other indicia of military service, for the purposes of section 1407 the date of initial enlistment or appointment is the date to be used.

Included among those who have become members of a uniformed service for purposes of section 1407 are cadets at the U.S. Military Academy, the U.S. Air Force Academy, the Coast Guard Academy, midshipmen at the U.S. Naval Academy, students enrolled in the senior ROTC of an armed force, students in the Uniformed Services

University of the Health Science, officer candidates attending Officer Training School, and persons in the Delayed Entry Program.

Subsection (e)(2) of section 2 of the bill amends paragraph (3) of section 1407(b) (relating to determining the monthly retired pay base of reservists retired under section 1331) to provide a new method for computing the monthly retired pay base of a reservist who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Under the existing provisions of section 1407(b)(3), the monthly retired pay base of a person who first became a member of a uniformed service after September 7, 1980, who is retired under section 1331 of title 10, is one thirty-sixth of the highest total amount of monthly basic pay to which he would have been entitled during any thirty-six month period (whether or not consecutive) during the period he was a member of a unformed service, had he served on active duty during those months.

Paragraph (2)(A) of subsection (e) redesignates paragraph (3) of section 1407(b) of subparagraph (3)(A).

Paragraph (2)(B) of subsection (e) inserts an introductory "Except as provided in subparagraph (B)" clause in section 1407(b)(3)(A) to clarify that this provision for determining the retired pay base does not apply for non-regular retirees who first became members on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Paragraph (2)(C) of subsection (e) adds a new subparagraph (3)(B) to section 1407(b) which prescribes a new rule for computing the monthly retired pay base for a person retired under section 1331 who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Under the new rule the monthly retired pay base is computed in the same manner as under existing law except that if a reservist who, having been notified under section 1331(d) of title 10 that he has completed the years of service required to qualify for retired pay, is thereafter transferred to an inactive status list or the Retired Reserve, months of membership in a uniformed service thereafter may not be included in the 36 months used for computation of the monthly retired pay base. However, the monthly retired pay base will be increased by the percentage by which the Consumer Price Index increases from the last of the 36 months used in the computation of that base to the month preceding the date on which the member is entitled to retired pay.

Paragraph (1) of section 2(f) of the bill amends chapter 71 of title 10 (relating to computation of retired pay for members of the Armed Forces) by adding a new section 1407a following section 1407 to provide a new percentage factor (multiplier) for use in the computation of retired or retainer pay of persons who first become members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Subsection (a) of new section 1407a changes the rules for the computation of the retired or retainer pay of persons who first become members of a uniformed service on or after the date of the

enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, and who become entitled to retired or retainer pay for any reason other than physical disability or non-regular service. Under current law such persons who have completed 20 or more years of active service are entitled to compute their retired or retainer pay by multiplying 2½ percent times their years of service creditable in computing that pay by either (a) the monthly basic pay of their retired grade if they first became a member of a uniformed service before September 8, 1980, or (b) their monthly retired or retainer pay base if they first became a member of a uniformed service after September 7, 1980.

There is no change in the existing method for computing the retired pay of persons retired for physical disability. There is a change in subsection (b) of new section 1407a for computing retired pay of persons entitled to retired pay for non-regular service (see discussion below).

The table in subsection (a) of section 1407a contains a listing of percentage factors to be used as a multiplier of the monthly retired or retainer pay base for persons who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

The table provides a percentage factor for each of the whole years of service from 20 through 30 which a member has to his credit for use as a multiplier in computing retired or retainer pay. The table is constructed on the basis of 2.20 percent multiplier for the first 20 years of service and a 3.10 percent multiplier for the years over 20, with a ceiling of 75 percent (which is the same ceiling as under existing law) for persons with 30 or more years of service.

In addition, footnotes to the table provide a formula for an increase in the percentage factor (by mathematical interpolation between the relevant percentage factors) for additional whole months of creditable service, disregarding any remaining fractional part of a month.

The effect of the proposed new method of computing retired or retainer pay would be to reduce by 12 percent the amount of retired pay for persons retiring with 20 years of service, with a gradual decrease in that reduction for those retired with 21 through 29 years of service and no reduction for those retired with 30 or more years of service. This new method for computing the percentage factor (multiplier) is referred to in the following sections of title 10 (as amended by the bill): 1401, 1402a, 3991, 3992, 6151, 6323, 6325, 6330, 6383, 8991 and 8992.

In addition, this new method of computing the percentage factor (multiplier) is referred to in new subsection (c) of section 423 of title 14 (as added by section 7(b)(4) of the bill), relating to computation of retired pay of members of the Coast Guard; in new paragraph (2) of subsection (a) of section 16 of the Coast and Geodetic Survey Commissioned Officer's Act of 1948 (33 U.S.C. 853o) (as added by section 8(4) of the bill), relating to computing the retired pay of commissioned officers of the National Oceanic and Atmospheric Administration; and in new subparagraph (C) of paragraph (3) of section 210(g) of the Public Health Service Act (42 U.S.C. 211(g)(3) and in new clause (7) of section 211(a) of such Act (42

U.S.C. 212(a)) (as added by sections 9(a)(3) and 9(b)(4) of the bill, respectively) relating to computing the retired pay of commissioned officers of the Public Health Service.

Subsection (b) of new section 1407a establishes a new rule for computing the retired pay for non-regular service (as authorized under section 1331 of title 10) for a person who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Under present law (section 1401 of title 10) a person who has completed 20 or more years of "satisfactory Federal service" as defined in section 1332 of title 10 is, at age 60, entitled to retired pay. That retired pay is computed by multiplying the "years" of service, including fractions thereof (as computed under section 1333 of title 10) by 2½ percent of either (1) the monthly basic pay of the highest grade held satisfactorily at any time, in the case of a person who first became a member of a uniformed service before September 8, 1980, or (2) the monthly retired pay base as computed under section 1407(b), in the case of a person who first became a member of a uniformed service after September 7, 1980.

Subsection (b) of new section 1407a would modify the computation of retired pay for non-regular service for such persons by applying a percentage factor (multiplier) provided in the table in that subsection to the amount of retired pay as computed under current law. These percentage factors have the effect of preserving the current method of computing the retired pay for non-regular service for reservists with 20 or more years of satisfactory Federal service, but reducing the amount of retired pay for such service at the same rate by which retired pay for persons retired with 20 or more years of active service is reduced under the bill. As with active service retirees, there is no reduction in the retired pay of reservists retired with 30 or more years of satisfactory Federal service.

Paragraph (2) of section 2(f) of the bill adds an item relating to new section 1407a in the table of sections at the beginning of chapter 71 of title 10.

Section 3 of the bill amends subsection (a) of section 1401a of title 10 (relating to adjustments in retired pay or retainer pay to reflect changes in the Consumer Price Index (CPI)) by adding two new definitions of terms, and amends subsection (b) by incorporating a modification of the existing provisions of subsection (b) in paragraph (1)(A), adding a new paragraph (1)(B), and adding new paragraphs (2) and (3).

Subsection (a) of section 1401a currently defines the term "Index" in the second sentence to mean the Consumer Price Index (all items, United States city average) published by the Bureau of Labor Statistics. As currently understood and applied the phrase "Consumer Price Index (all items, United States city average)," refers to the Consumer Price Index for urban wage earners and clerical workers. For purposes of clarity, the term "Index" is changed to "price index," with no change in the meaning. Because of changes made in subsection (b) of section 1401a, the terms "base quarter" and "price index for a base quarter" are also defined in the second sentence of subsection (a), conforming them to their usage and definition in section 8340 of title 5, the current basis for

cost of living adjustments in retired and retainer pay. "Base quarter" is defined as the calendar quarter ending on September 30 of each year, and "price index for a base quarter" is defined as the arithmetical mean of the price index for the three months comprising the base quarter.

Subsection (b) of section 1401a currently provides that each time the annuities authorized for civil service annuitants under subchapter III of chapter 83 of title 5 are increased to reflect increases in the cost of living, the Secretary of Defense shall at the same time increase the retired or retainer pay of members of the Armed Forces by the same percent as the percentage by which those annuities are increased. Paragraph (1) of amended section 1401a(b) directs the Secretary of Defense to issue regulations which will provide CPI increases in a manner similar to that currently authorized, except that instead of the increases being linked to the determination of increases for civil service annuitants they will be determined directly by the Secretary of Defense based on the Consumer Price Index.

Clause (A) of amended section 1401a(b)(1) provides for increases for members of the armed services who first became members of a uniformed service before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, or who are retired under chapter 61 of title 10 United States Code on the same basis as under the current system. Such members are "grandfathered" with respect to cost of living increases.

Clause (B) of amended section 1401a(b)(1) will reduce by one percent the amount of the periodic CPI increases for those retired members of the Armed Forces who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, and are not entitled to retired pay for disability under chapter 61 of title 10.

Paragraph (2) of amended section 1401a(b) provides for a one-time "catch up" by means of a recomputation of the retired or retainer pay of any member of the Armed Forces (other than a member retired under chapter 67 of title 10) whose retired pay or retainer pay was reduced in accordance with the provisions of paragraph (1)(B) of section 1401a(b), with the recomputation to occur on the date of the first increase in retired pay authorized under the provisions of paragraph (1)(B) after the member completes 40 years as a member of a uniformed service. The retired pay that such a member is entitled to receive at the time of that recomputation is an amount equal to the amount of retired pay that member was entitled to at retirement increased by the change in CPI from time of retirement until the 40th anniversary of service. Thereafter, such a member would continue to receive CPI increases with the reductions as provided in paragraph (1)(B). The retired pay of reservists retired under chapter 67 of title 10 is not recomputed under this paragraph because their retired pay base was initially adjusted at the time of retirement under section 1407(b)(3)(B) of Title 10, as amended by the bill.

Paragraph (3) of amended section 1401a(b) provides for the Secretary of Defense to issue regulations governing the payment of COLAs.

Paragraph (4) of amended section 1401a(b) defines "years as a member of a uniformed service" for the purpose of this subsection. Such years include all periods of service creditable for determining the member's basic pay under section 205 of title 37 at the time he retires, as well as all periods while entitled to retired pay. A restriction provides that no period may be counted more than once.

Section 4 of the bill amends subtitle B of title 10 by amending sections 3991 and 3992 as they relate to the computation of retired pay of members of the Army who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. The amendments require the use of the percentage factor (multiplier) prescribed in new section 1407a, as added by subsection (f) of section 2 of the bill, rather than the formula prescribed in existing law.

Subsection (a) of section 4 of the bill amends section 3991 (relating to computation of retired pay of members of the Army) as follows:

Clause (A) of section 4(a)(1) of the bill redesignates the text of existing section 3991 as subsection 3991(a).

Clause (B) of section 4(A)(1) of the bill amends the redesignated subsection 3991(a) by inserting "who first became a member of a uniformed service (as defined in section 1407(a)(2) of this title) before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986," after "subtitle". This change limits the computation of retired pay under new subsection 3991(a) to a member who first became a member of a uniformed service before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Thus, it preserves for such members the entitlement to use the current formula that authorizes 2½ percent for each year of creditable service as a multiplier in computing their retired pay.

Paragraph (2) of section 4(a) of the bill adds "(a)" after "1401" in the fourth sentence of subsection 3991(a), as redesignated, to reflect the redesignation of the existing text of section 1401(a).

Paragraph (3) of section 4(a) of the bill adds a new subsection (b) to section 3991 to provide a new formula for computing the retired pay of a member who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under the new formula the percentage factor (multiplier) prescribed by new section 1407a, as added by section 2(f) of the bill, would be used to compute retired pay. These changes correspond to the changes made to section 1401 by section 2(a) of the bill.

Subsection (b) of section 4 of the bill amends section 3992 (relating to recomputation of retired pay to reflect advancement on the retired list of members of the Army).

Paragraph (1) of section 4(b) of the bill incorporates the substance of the existing section 3992 in subsection 3992(a) and limits the recomputation of retired pay for an enlisted member and a warrant officer advanced to a higher grade under the provisions of redesignated subsection (a) to a member who first became a member of a uniformed service before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. This

change preserves for such members the entitlement to use the existing formula that authorizes 2½ percent for each year of service as a multiplier in computing their retired pay.

Paragraph (2) of section 4(b) of the bill adds a new subsection (b) to section 3992 to provide a new formula for recomputing retired pay of enlisted members and warrant officers upon advancement on the retired list to a higher grade. Under the new formula, the percentage factor (multiplier) prescribed by new section 1407a, as added by section 2(f) of the bill, would be used to recompute retired pay.

Section 5 of the bill amends subtitle C of title 10 by amending sections 6151, 6323, 6325, 6330 and 6383 as they relate to the computation of retired or retainer pay of members of the Navy and Marine Corps who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, to require the use of the percentage factor (multiplier) prescribed in new section 1407a, as added by section 2(f) of the bill, rather than the formula prescribed in current law. Under existing law members of the Navy and Marine Corps are entitled to compute their retired or retainer pay by multiplying 2½ percent times the years of service creditable in computing their retired or retainer pay by either (a) the monthly basic pay of the grade in which retired, if they first became a member of a uniformed service before September 8, 1980, or (b) their monthly retired or retainer pay base, if they first became a member of a uniformed service after September 7, 1980.

Subsection (a) of section 5 of the bill amends subsections (b) and (c) of section 6151 of title 10 (relating to determination of higher retired grade and pay in the case of persons advanced on the retired list). Under existing section 6151(b)(1)(A), a person (other than a former member of the Fleet Reserve or Fleet Marine Corps Reserve) who first became a member of a uniformed service before September 8, 1980, and who is advanced on the retired list to a higher grade, is entitled to compute his retired pay by multiplying the monthly basic pay for that higher grade by 2½ percent of the years of service credited to him under section 1405 of title 10. That provision is not changed.

Clause (A) of section 5(a)(1) of the bill amends section 6151(b)(1)(B) by striking out the words "on or after September 8, 1980" and inserting in lieu thereof the words "after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986,". The effect of this change is to limit the applicability of the retired pay formula in clause (b) of section 6151(b)(1) to members of the Navy and Marine Corps (other than former members of the Fleet Reserve or Fleet Marine Corps Reserve who are covered by section 6151(c)(2) (see discussion below of section 5(a)(2)(A) of the bill)) advanced on the retired list who first became members of a uniformed service after September 7, 1980 but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. This change is required in view of the new method prescribed in new paragraph (2) of section 6151(b), as added by section 5(a)(1)(C) of the bill (see discussion below), for computing the retired pay for persons advanced on the retired list who first became members of a uniformed serv-

ice on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Clause (B) of section 5(a)(1) of the bill redesignates existing paragraph (2) of section 6151(b) as paragraph (3).

Clause (C) of section 5(a)(1) of the bill amends section 6151(b) by adding a new paragraph (2) which provides that a member of the Navy and Marine Corps (other than a former member of the Fleet Reserve or Fleet Marine Corps Reserve) who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, and who is advanced on the retired list shall, in the computation of his retired pay, use the percentage factor (multiplier) prescribed by new section 1407a, as added by section 2(f) of the bill, rather than the formula prescribed in current law.

Clause (A) of section 5(a)(2) of the bill amends section 6151(c) by striking out the words "on or after September 8, 1980" in paragraph (2) and inserting "after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986," in lieu thereof. The effect of that change is to limit the applicability of the existing retired pay formula in section 6151(c)(2) (relating to advancement on the retired list of former members of the Fleet Reserve or Fleet Marine Corps Reserve) to those members who first became members of a uniformed service after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Clause (B) of section 5(a)(2) of the bill amends section 6151(c) by adding a new paragraph (3) which provides that each former member of the Fleet Reserve or Fleet Marine Corps Reserve who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, and who is advanced on the retired list, shall, in the computation of his retired pay, use the percentage factor (multiplier) prescribed in new section 1407a, as added by section 2(f) of the bill, rather than the formula prescribed in current law.

Subsection (b) of section 5 of the bill amends subsection (e) of section 6323 (relating to retirement of officers after 20 years of service).

Paragraph (1) of section 5(b) of the bill amends section 6323(e) by inserting "(1)" after "(e)" to reflect the redesignation of the existing text (as amended) as paragraph (1).

Paragraph (2) of section 5(b) of the bill amends section 6323(e) by redesignating existing paragraphs (1) and (2) as clauses (A) and (B), and by amending clause (B), as redesignated, by striking out the words "on or after September 8, 1980" and inserting "after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986," in lieu thereof. The effect of this change is to limit the applicability of the retired pay formula in the redesignated clause (B) of section 6323(e)(1) to those officers who first became members of a uniformed service after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Paragraph (3) of section 5(b) of the bill amends section 6323(e) by adding a new paragraph (2) which provides that an officer retired under section 6323(e) who first became a member of a uniformed

service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, shall, in the computation of his retired pay, use the percentage factor (multiplier) prescribed in new section 1407a, as added by section 2(f) of the bill, rather than the formula prescribed in current law.

Subsection (c)(1) of section 5 amends section 6325(a)(2) (relating to retired grade and pay of certain officers of the Navy and Marine Corps).

Clause (A) of section 5(c)(1) of the bill strikes out "; or" at the end of clause (A) of section 6325(a)(2) and adds language providing that the monthly basic pay would be multiplied by the years of service credited under section 1405, but that the amount of retired pay so computed could not exceed 75 percent of the monthly basic pay of the member's retired grade. The added language merely relocates in clause (A) the existing text currently contained in the last sentence of section 6325(a)(2), which is deleted by clause (D) of section 5(c)(1) of the bill (see discussion below).

Clause (B) of section 5(c)(1) of the bill amends clause (B) of section 6325(a)(2) by limiting the applicability of the retired pay formula to those officers who first became members of a uniformed service after September 8, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. This change is necessary in view of the new rule for such officers set out in new clause (C) added to section 6325(a)(2) by clause (E) of section 5(c)(1) of the bill (see discussion below).

Clause (C) of section 5(c)(1) of the bill further amends clause (B) of section 6325(a)(2) by striking out the semicolon at the end and adding language providing that the monthly retired pay base would be multiplied by the years of service credited under section 1405, but that the amount of retired pay computed under that clause could not exceed 75 percent of the monthly retired pay base. The added language merely relocates in clause (B) the existing text currently contained in the last sentence of section 6325(a)(2), which is deleted by clause (D) of section 5(c)(1) of the bill (see discussion below).

Clause (D) of section 5(c)(1) of the bill deletes from paragraph (2) of section 6325(a) the existing language which has been inserted in clause (A) and clause (B) of section 6325(a)(2) by clauses (A) and (C) of section 5(c)(1) of the bill (see discussion above).

Clause (E) of section 5(c)(1) of the bill adds a new clause (C) to section 6325(a)(2). New clause (C) provides that in the case of an officer who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, his retired pay would be computed by using the percentage factor (multiplier) prescribed in new section 1407a, as added by section 2(f) of the bill.

Subsection (c)(2) of section 5 of the bill amends section 6325(a)(2) (relating to retired grade and pay of certain officers of the Navy and Marine Corps).

Clause (A) of subsection 5(c)(2) of the bill strikes out "; or" at the end of clause (A) of section 6325(b)(2) and adds language providing that the monthly basic pay would be multiplied by the years of service credited under section 1405, but that the amount of retired pay so computed could not exceed 75 percent of the monthly basic

pay of the member's retired grade. The added language merely relocates in clause (A) the existing text of the language currently contained in the last sentence of section 6325(b)(2), which is deleted by clause (D) of section 5(c)(2) of the bill (see discussion below).

Clause (B) of section 5(c)(2) of the bill amends clause (B) of section 6325(b)(2) by limiting the applicability of the retired pay formula to those officers who first became members of a uniformed service after September 8, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. This change is necessary in view of the new rule for such officers set out in new clause (C) as added by clause (E) of section 5(c)(2) of the bill (see discussion below).

Clause (C) of section 5(c)(2) of the bill further amends clause (B) of section 6325(b)(2) by striking the semicolon at the end and adding language providing that the monthly retired pay base would be multiplied by the years of service credited under section 1405, but that the amount of retired pay so computed could not exceed 75 percent of the monthly retired pay base. The added language merely relocates in clause (B) the existing text currently contained in the last sentence of paragraph (2), which is deleted by clause (D) of section 5(c)(2) of the bill (see discussion below).

Clause (D) of section 5(c)(2) of the bill deletes from paragraph (2) of section 6325(b) the existing language which has been inserted in clause (A) and clause (B) of section 6325(b)(2) by clauses (A) and (C) of section 5(c)(2) of the bill (see discussion above).

Clause (E) of section 5(c)(2) of the bill adds a new clause (C) to section 6325(b)(2), which provides that in the case of an officer who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, his retired pay would be computed by using the percentage factor (multiplier) prescribed in new section 1407a, as added by section 2(f) of the bill.

Subsection (d) of section 5 of the bill amends paragraph (1) of section 6330(c) (relating to transfer of enlisted members of the Navy and Marine Corps to the Fleet Reserve or the Fleet Marine Corps Reserve and the computation of retainer pay for those so transferred). Under existing law enlisted members of the Navy and Marine Corps who are transferred to the Fleet Reserve or the Fleet Marine Corps Reserve are entitled to compute their retainer pay by multiplying 2½ percent times the years of service creditable in computing their retainer pay by either (a) the monthly basic pay of the grade in which so transferred, if they first became a member of a uniformed service before September 8, 1980, or (b) their monthly retainer pay base if they first became a member of a uniformed service after September 7, 1980.

Paragraph (1) of subsection 5(d) amends clause (A) of section 6330(c)(1) by deleting the word "or" at the end and incorporating in clause (A) the existing text at the end of paragraph (1), which has the effect of preserving the current method of computing retainer pay for those enlisted members of the Navy and Marine Corps who first became members of a unformed service before September 8, 1980.

Paragraphs (2) and (3) of section 5(d) of the bill amend clause (B) of section 6330(c)(1) by deleting the words "on or after September 8,

1980," and inserting the words "after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986," in lieu thereof, and by deleting the semicolon at the end and adding "multiplied by the number of years of active service in the Armed Forces; or". These changes preserve the formula contained in that clause for those persons who first became members of a uniformed service after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Paragraph (4) of section 5(d) of the bill deletes the language at the end of section 6330(c)(1) made surplus by the amendments to paragraphs (1)(A) and (1)(B) of section 6330(c).

Paragraph (5) of section 5(d) of the bill adds new clause (C) to section 6330(c)(1) to provide that an enlisted member of the Fleet Reserve or Fleet Marine Corps Reserve who first became a member of a uniformed service on or after the date of the enactment of the Unformed Services Retirement Cost Reduction Act of 1986, shall, in the computation of his retainer pay, use the new percentage factor (multiplier) prescribed in new section 1407a, as added by section 2(f) of the bill, rather than the formula prescribed in existing law.

Subsection (e) of section 5 of the bill amends paragraph (2) of section 6383(c) (relating to the retirement and computation of retired pay of certain officers of the regular Navy and Marine Corps) by restructuring existing clauses (A) and (B) and by adding a new clause (C).

Clause (A) of section 6383(c)(2) is amended by incorporating within the clause the language at the end of paragraph (2). This preserves the formula prescribed in existing law for computing the retired pay of those officers who first became members of a uniformed service before September 8, 1980.

Clause (B) of section 6383(c)(2) is amended by incorporating within the clause the language at the end of paragraph (2). This preserves the formula prescribed in existing law for computing the retired pay of those officers who first became members of a uniformed service after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

A new clause (C) of section 6383(c)(2) is added. This clause provides that those officers retired under section 6383 who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, shall, in the computation of their retired pay, use the percentage factor (multiplier) prescribed in new section 1407a, as added by section 2(f) of the bill, rather than the formula prescribed in current law.

Section 6 of the bill amends subtitle D of title 10 by amending sections 8991 and 8992 as they relate to the computation of retired pay of members of the Air Force who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. The amendments require the use of the percentage factor (multiplier) prescribed in new section 1407a, as added by section 2(f) of the bill, rather than the formula prescribed in existing law.

Subsection (a) of section 6 of the bill amends section 8991 (relating to computation of retired pay of members of the Air Force) as follows:

Clause (A) of section 6(a)(1) of the bill redesignates the text of existing section 8991 as subsection 8991(a).

Clause (B) of section 6(a)(1) of the bill amends the redesignated subsection 8991(a) by inserting "who first became a member of a uniformed service (as defined in section 1407(a)(2) of this title) before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986," after "subtitle". This change limits the computation of retired pay under new subsection 8991(a) to a member who first became a member of a uniformed service before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Thus, it preserves for such members the entitlement to use the current formula that authorizes 2½ percent for each year of creditable service as a multiplier in computing their retired pay.

Paragraph (2) of section 6(a) of the bill adds "(a)" after "1401" in the fourth sentence of subsection 8991(a), as redesignated, to reflect the redesignation of section 1401 as section 1401(a).

Paragraph (3) of section 6(a) of the bill adds a new subsection (b) to section 8991 to provide a new formula for computing the retired pay of a member who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under the new formula the percentage factor (multiplier) prescribed by new section 1407a, as added by section 2(f) of the bill, would be used to compute retired pay. These changes correspond to the changes made to section 1401 by section 2(a) of the bill.

Subsection (b) of section 6 of the bill amends section 8992 (relating to recomputation of retired pay to reflect advancement on the retired list of members of the Air Force).

Paragraph (1) of section 6(b) of the bill incorporates the substance of the existing section 8992 in subsection 8992(a) and limits the recomputation of retired pay for an enlisted member and a warrant officer advanced to a higher grade under the provisions of redesignated subsection (a) to a member who first became a member of a uniformed service before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. This change preserves for such members the entitlement to use the existing formula that authorizes 2½ percent for each year of service as a multiplier in computing their retired pay.

Paragraph (2) of section 6(b) of the bill adds a new subsection (b) to section 8992 to provide a new formula for recomputing retired pay of enlisted members and warrant officers upon advancement on the retired list to a higher grade. Under the new formula, the percentage factor (multiplier) prescribed by new section 1407a, as added by section 2(f) of the bill, would be used to recompute retired pay.

Section 7 of the bill amends title 14 in section 288 (relating to the retirement of captains), section 423 (relating to computation of retired pay), and section 424 (relating to limitations in retirement and retired pay) to reflect the adoption of the new method of computing non-disability retired pay for members of the Coast Guard

who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Subsection (a) of section 7 of the bill amends section 288(b) (relating to retirement of regular captains) by inserting "and (c)" after "section 23(b)" to reflect the amendment of section 423 by section 7(b) of the bill.

Subsection (b) of section 7 of the bill amends section 423 (relating to computation of retired pay).

Paragraph (1) of section 7(b) of the bill amends the first sentence of subsection 423(a) by inserting "and (c)" after "subsection (b)" to include new subsection (c) in the opening "Except as provided" clause.

Paragraph (2) of section 7(b) of the bill amends the fourth sentence of subsection 423(a) by inserting "or by which the percentage factor is determined under subsection (c)" after "multiplied" to reflect the new method of computing retired pay under new subsection (c).

Paragraph (3) of section 7(b) of the bill amends section 423(b) by inserting "but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986" after "September 7, 1980,". This change preserves the existing entitlement that authorizes 2½ percent for each year of service as a multiplier in computing the retired pay of a member of the Coast Guard who first became a member of a uniformed service after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Paragraph (4) of section 7(b) of the bill adds a new subsection (c) to section 423 to provide a new formula for computing the retired pay of a member who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under the new formula the percentage factor (multiplier) prescribed by new section 1407a of title 10, as added by section 2(f) of the bill, would be used to compute retired pay. This new formula does not apply to the computation of disability retired pay.

Subsection (c) of section 7 of the bill amends section 424 by striking the word "The" in the first sentence and inserting "Except as provided in section 423 (b) and (c) of this title, the" in lieu thereof. This amendment makes clear that the limitations in section 424 do not affect the computation of retired pay in section 423 (b) and (c).

Section 8 of the bill amends section 16(a) of the Coast and Geodetic Survey Commissioned Officers' Act of 1948 (section 8530 of title 33) (relating to computation of retired pay of commissioned officers of the National Oceanic and Atmospheric Administration) to reflect the new method of computing non-disability retired pay for commissioned officers of the National Oceanic and Atmospheric Administration who first become members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Paragraphs 1 and 2 of section 8 of the bill insert "(1)" after "(a)", thereby redesignating section 16(a) as 16(a)(1), and redesignate existing paragraphs (1) and (2) of section 16(a) as clauses (A) and (B), respectively.

Paragraph (3) of section 8 amends redesignated clause (B) by striking out "on or after September 8, 1980," and inserting in lieu thereof "after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986,". This change preserves the existing entitlement that authorizes 2½ percent for each year of service as a multiplier in computing the retired pay of a commissioned officer of the National Oceanic and Atmospheric Administration who first became a member of a uniformed service before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Paragraph (4) of section 8 adds a new paragraph (2) to section 16(a) to reflect the new formula for computing the retired pay of a commissioned officer who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under the new formula the percentage factor (multiplier) prescribed by new section 1407a of title 10, as added by section 2(f) of the bill, would be used to compute retired pay. This new formula does not apply to the computation of disability retired pay.

Section 9 of the bill amends section 210(g)(3) of the Public Health Service Act (section 211(g)(3) of title 42) (relating to separation and retirement of officers upon failure of section for promotion) and section 211 of that Act (section 212 of title 42) (relating to retirement of commissioned officers) to reflect the adoption of the new method of computing non-disability retired pay for commissioned officers of the Public Health Service who first became members of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Section 9(a) of the bill amends section 210(g)(3) of the Public Health Service Act (section 211(g(3) of title (42) (relating to computation of retired pay of commissioned officers).

Paragraph (1) of section 9(a) of the bill strikes out "or" at the end of subparagraph (A) of section 210(g)(3).

Paragraph (2) of section 9(a) of the bill amends subparagraph (B) of section 210(g)(3) by striking out "on or after September 8, 1980," and inserting in lieu thereof "after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986," and by striking out the period at the end thereof and inserting "; or" in lieu thereof. This amendment reflects that subparagraph (B) applies only to officers who first became members of a uniformed service after September 7, 1980, but before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, and preserves the existing method of computing their retired pay.

Paragraph (3) of section 9(a) of the bill adds to section 210(g)(3) a new subparagraph (C) that contains a new formula for computing the retired pay of an officer who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under the new formula the percentage factor (multiplier) prescribed by new section 1407a of title 10, as added by section 2(f) of the bill, would be used to compute retired pay. This new formula does not apply to the computation of disability retired pay.

Paragraph (b) of section 9 of the bill contains three amendments to section 211(a) of the Public Health Service Act (section 212(a) of title 42).

Paragraph (1) of section 9(b) of the bill amends the first sentence of paragraph 4 of section 211(a) by inserting "or (7)" after "paragraph (6)" to include reference to new paragraph (7).

Paragraph (2) of section 9(b) of the bill redesignates existing paragraph (7) of section 211(a) as paragraph (8).

These first two amendments to section 211(a) preserve the existing entitlement that authorizes 2½ percent for each year of service as a multiplier in computing the retired pay of a commissioned officer who first became a member of a uniformed service before the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Paragraph (3) of section 9 of the bill adds a new paragraph (7) to section 211(a) that contains a new formula for computing the retired pay of a commissioned officer of the Public Health Service who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under the new formula the percentage factor (multiplier) prescribed by new section 1407a of title 10, as added by section 2(f) of the bill, would be used to compute retired pay. This new formula does not apply to the computation of disability retired pay.

Section 10 of the bill amends section 1331(a) of title 10 (relating to age and service requirements for retired pay for non-regular service) to provide that a person who first became a member of a uniformed service on or after the date of the enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, is entitled to retired pay for non-regular service only if he is a member of a reserve component at the time he otherwise becomes entitled to such retired pay.

Under current section 1331(a), there is no requirement that a person who is otherwise qualified for retired pay for non-regular service must have a military status as a precondition to receipt of such pay. The proposed change brings the rules for receipt of retired pay for non-regular service into conformity with the rules for receipt of other types of military retired pay by requiring the recipient of that pay to hold a military status.

Section 11 of the bill amends subchapter II of chapter 73 of title 10 (relating to the Survivor Benefit Program) by adding at the end of that subchapter a new section 1456 which will provide for continuation of present law relating to retired pay for the purposes of computing withholding from retired pay and the amount of annuities under that plan.

Subsection (2) of section 11 of the bill adds a new section 1456 to title 10. Subsection (a) of that new section 1456 provides that in determining the amount of annuity payable to a beneficiary of a person who first became a member of a uniformed service after the date of enactment of the Uniformed Services Retirement Cost Reduction Act of 1986, the annuity shall be determined on the basis of laws in effect relating to computation of retired pay on the day before the date of enactment of the Uniformed Services Retirement Cost Reduction Act of 1986. Under that subsection the term "first

became a member of a uniformed service" has the same meaning given that term by section 1407(a)(2)(B) of title 10, as added by section 2(e)(1) of the bill. Subsection (b) of new section 1456 of title 10 would provide that in computing a member's retired pay for purposes of determining the amount of an annuity payable to a beneficiary of a person who first became a member of a uniformed service after the date of enactment of the Uniformed Service Retirement Cost Reduction Act of 1986, and for purposes of determining the amount of reduction in the retired pay of such a person in order to provide any annuity under the Plan, the member's retired pay would be computed based on the laws in effect with respect to computation of retired pay on the day before the date of enactment of the Uniformed Services Retirement Cost Reduction Act of 1986.

Subsection (b) of section 11 of the bill would make a conforming amendment to the table of sections at the beginning of subchapter II of Chapter 73 of title 10 to reflect the addition of that subchapter of new section 1456.

Subsection 12 of the bill would repeal section 666 of the Department of Defense Authorization Act, 1986, which placed obligational limits on the military personnel accounts during fiscal year 1986 at a level $2.9 billion below that required for the Department of Defense to pay its forces and to make the required payments in the Department of Defense Military Retirement Fund during fiscal year 1986 under the existing retirement entitlement structure.

DEPARTMENTAL VIEWS

The Department of Defense submitted the following report with the draft legislative proposals in accordance with the direction contained in section 667 of the Defense Authorization Act for fiscal year 1986:

THE SECRETARY OF DEFENSE

WASHINGTON, THE DISTRICT OF COLUMBIA

15 NOV 1985

Honorable George Bush
President of the Senate
Washington, D.C. 20510

Dear Mr. President:

The enclosed report complies with the requirements of section 667 of the Defense Authorization Act for fiscal year 1986.

Included in the report are drafts of the two pieces of legislation that would change the military non-disability retirement system. Each would result in a reduction in military retirement accrual funding of $2.9 billion in fiscal year 1986 as mandated by the Congress. This is a 16 percent reduction in military retired pay from the current system and is in addition to the 13 percent reduction that was imposed by the Congress in the high-three-year averaging adjustment in 1980.

Although the Department of Defense has prepared the draft legislation as required by the Congress, I want to make it absolutely clear that such action is not to be construed as support for either of the options for change. To the contrary, the Department of Defense is steadfastly opposed to the significant degradation in future combat readiness that would result from the changes required to achieve the mandated reduction. I am particularly concerned about the potential loss of mid-level officers, NCOs and Petty Officers who provide the first-line leadership and technical know-how so vital to the defense mission. Unless offsetting compensation is provided, our models conservatively indicate that our future manning levels in the 10 to 30 year portion of the force would drop below the dismal levels of the late 1970s when aviator shortages and shortfalls in Army NCO and Navy Petty Officer leadership seriously degraded our national security posture.

While the changes we have been required to submit technically affect only future entrants, we expect an insidious and immediate effect on the morale of the current force. No matter how the reduction is packaged, it communicates the same message, i.e., the perception that there is an erosion in support from the American people for the Service men and women whom we call upon to ensure our safety. It says in absolute terms that the unique, dangerous and vital sacrifices they routinely make are not worth the taxpayers' dollars they receive, which is not overly generous. I do not believe the majority of the American people support this view and ask that you consider this in your deliberations on this very crucial issue to our national security.

Sincerely,

Enclosure

DOD REPORT TO THE CONGRESS

ON OPTIONS TO

REDUCE MILITARY RETIREMENT ACCRUAL FUNDING

IN FISCAL YEAR 1986

SECTION 1

INTRODUCTION

This report on the military retirement system is submitted in accordance with section 667 of the Department of Defense Authorization Act, 1986.

Military Retirement System: Unlike the majority of retirement programs in the civilian sector, the military retirement system is not an old-age income maintenance plan. Rather, it is designed and intended to operate as an element of the military compensation structure and as an element of the personnel management system. Retired pay has been characterized by the Supreme Court as reduced pay for reduced military service on the basis that members retain their military status, remain subject to the Uniform Code of Military Justice, and are subject to recall to military duty. Indeed, contingency mobilization plans include the recall of retired members to supplement the active standing force and reserve force.

Unlike civilian retirement plans, there are no rights of ownership to military retired pay--receipt is a conditional entitlement subject to the provision of continued enabling legislation. These statutory restrictions and limitations are not resident in any civilian retirement program, public or private, and have been enacted into law recognizing the governmental function to provide for the security and defense of the nation. As such, statutory requirements extend sovereign authority to the retired military community and set aside certain personal freedoms, rights, and entitlements for the common good of the country. This basic function of government--to provide for the defense and protection of the citizenry--has been reflected in the military retirement laws and underlies its basic purpose.

As a personnel management tool, the retirement system operates as a retention incentive and an egress mechanism to shape and sustain the force compatible with the defense requirements and readiness capability that must be maintained to fulfill the national defense mission. Through retirement and separation, the age/skill/experience mix of the active force is kept in proper balance with military requirements. This reflects the necessity of maintaining a youthful and vigorous force capable of sustained combat, of providing a means of enhancing the flow of experience and talent through the force, and of offering a means to remove individuals selectively from the force consistent with the force profile requirements. For individuals it offers an incentive for career commitments, and for management it permits selective retention to maintain a quality force.

Many proponents of change advocate revision based upon cost considerations only without regard to the effect on force composition or readiness capability. Such criticism fails to

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recognize the national policy to maintain a standing force of at least two million since the mid-1950s. That force size is now reflected in a maturing retirement system--the force size is stabilizing. In concert with continued control of inflation, retired pay growth will stabilize and cease to be a cost growth issue in about 20 years.

Military Service--"A Way of Life": The most common misconception among critics of military compensation is the equating of military service with civilian employment. The two are distinctly different. Military service is distinctly different from civilian employment by the very nature of such service. To be a member of the military service is to agree to accept the surrender of certain personal freedoms. There is no such sacrifice in civilian employment. The Service member can be ordered to go anywhere at anytime. He has taken an oath to serve. If the member does not like the orders he receives, e.g., the location of the next duty station, he cannot change jobs. No civilian job restricts the personal freedom of an individual in this way.

A military career demands long hours of work with no overtime pay, forced family separations, frequent exposure to risk, inability to control one's working and living conditions, the acceptance of a highly disciplined life and the abridgment of individual freedoms. It takes unique people to give of themselves in such measure. While personal satisfaction can be achieved through a military career, Service members know that their personal preferences must be subordinated to the good of the military unit (whether it be an infantry squad or the crew of a ship or aircraft) and of the entire nation. Thus, the call to serve in the armed forces is less a "job" and more "a way of life." Because it is a way of life, body and soul, the compensation structure is entirely different.

The way of life is not limited to the Service member alone. It is a way of life for the military family as well. Military service involves both frequent and lengthy periods of separation from the family. The spouse is forced to assume the role of a single parent with all the pressures and responsibilities that entails. The Service member is often absent as the children grow, when they enter school, and as they attempt to adjust to a new environment incident to frequent moves. The spouse attempts to obtain employment and finds that the periodic moves result in higher unemployment rates and lower salaries for the working military spouse. Finally, the military member and his family realize that many of his civilian counterparts have developed an equity in their home that represents a savings that can be used in old age or to finance the children's education. The periodic moves, time overseas and government housing develop no such savings. The Service member's primary savings is the military retirement pay he has developed through years of service to the nation.

Basic Question: If military retirement benefits are too great or too lucrative as some have claimed, why do so few remain for a career? The fact is that given existing pay and the existing military retirement system, additional reenlistment bonus funding has been required to retain Service members. The reduced retirement benefit implemented in 1980 for new entrants--high-3--has decreased the average value of military retirement pay by 13 percent. This reduction will affect retention in the early 1990s as Service members reach their second reenlistment point and evaluate military retirement pay as an incentive.

Events Leading to This Report: Until 1984, military retired and retainer pay was financed on a "pay-as-you-go" basis. Funds to defray the costs of retired and retainer pay entitlements of retired military personnel were appropriated annually by Congress and charged to the Department of Defense operating budget. Partially because this method of financing military retirement pay did not adequately recognize the future costs of current manpower and force-structuring decisions, and partially because it was not consistent with the then-current practice of private sector employers under the Employee Retirement Income Security Act of 1974, Congress adopted, in the Department of Defense Authorization Act, 1984, a requirement to establish a Department of Defense Military Retirement Fund (see sections 1461 through 1467 of title 10, United States Code).

Accordingly, the Department of Defense now "pays" for military retirement benefits when they are being earned by members of the active duty force and the selected reserve, not when such members later become entitled to benefits. Actuarially determined payments that represent the accrued cost of future military retirement payments attributable to a given year's service by members of the armed forces are made to the Fund for that year. Because such payments appear in the Department of Defense personnel budget each year, the Congress reviews future retirement costs annually.

In reviewing the Department of Defense's proposed budget for fiscal year 1986 for authorization purposes, both the House and Senate Committees on Armed Services recommended a ceiling on the total dollars available for transfer to the Military Retirement Fund. The Senate recommended a reduction of $1.8 billion, while the House recommended $4 billion. The Committee of Conference on S. 1160 agreed on $2.9 billion.

Pursuant to that agreement, the Secretary of Defense was instructed to submit two alternative proposals for changing the non-disability retirement system to achieve the $2.9 billion reduction. One of the proposals was to achieve the required reduction by changes to the military retirement system other than by changing the procedure for periodic cost-of-living adjustments, i.e., structure-only change; the second was unconstrained.

The Congressional guidance provided that changes should not apply to any individual already retired or to any individual who had entered the military before the effective date of the legislation; that such changes should, to the extent compatible with military requirements, encourage members who become eligible for retirement after completing 20 years of service to remain on active duty; and that the actuarial methods and assumptions used to calculate the savings shall be the same as those approved by the Board of Actuaries for use in calculating the military retirement accrual funding in the President's budget for FY 86.

Report: The report is organized into six sections and responds to the specific requests of Congress as follows:

- This, the first section, provides background information on the military retirement system, summarizes events leading to the report, and provides an outline of the report.

- The second describes the two options developed in response to Congressional direction to reduce retirement accrual funding by $2.9B in FY 86.

- In the third section, several quantitative methods are used to analyze the impact of these options on the individual, on retention and recruiting and on combat readiness.

- The fourth section provides the Department's views on a four-year transition plan.

- In the fifth section, the Department's views are provided on adjustments to other personnel or military compensation policies that would be required should retirement benefits be reduced.

- Finally, the sixth section analyzes the impact of the five specified levels of military retirement accrual funding reduction--$1.8B, $2.9B, $3.6B, $4.0B, and $5.4B--employing the quantitative methods used to analyze the impact of the two options in the third section.

Tables and figures are included in the sections they support. The draft legislation for the two options to reduce retirement accrual by $2.9B in FY 86 are attached as Appendix A and B.

SECTION 2

TWO OPTIONS TO ACHIEVE A $2.9B REDUCTION IN RETIREMENT ACCRUAL FUNDING IN FY 86

As directed by the Congress, the Department of Defense has developed two options to reduce retirement accrual funding by $2.9B in FY 86. The $2.9B savings would occur if the new system applied as of October 1, 1985, to new entrants only. All current and former Service members would be totally grandfathered, i.e., would continue to accrue retirement benefits under the retirement system currently in effect for them.

Development of these two options and submission to the Congress should not be construed to mean that the Department of Defense supports either option. To the contrary, the Department is opposed to this significant reduction in military retirement benefits for the men and women who will serve their country in uniform in the future.

Of the two options submitted, one is a structure-only change involving reduced multipliers for years of service and incorporating high-5 (highest 60 months' basic pay) as the basis for determining retirement pay. The other is a combination option which includes reduced multipliers and a reduction to the cost-of-living adjustment (COLA). The combination option assumes high-3 (highest 36 months' basic pay) as the basis for determining retirement pay, which has been in effect for new entrants since September 8, 1980.

The two options are:

- o Structure-only
  - Basis: high-5, retired pay computed based on highest 60 months' basic pay
  - Multipliers:
    - -- 2.15 percent per year for years 1-20
    - -- 3.2 percent per year for years 21-30
  - COLA: existing system of full CPI
- o Combination
  - Basis: existing high-3 system for new entrants
  - Multipliers:
    - -- 2.2 percent per year for years 1-20
    - -- 3.1 percent per year for years 21-30

- COLA: Non-disability retirees would receive CPI-1 for life with restoral at the 40th anniversary of entry into service. Retirees would receive a COLA of the percentage increase in the Consumer Price Index minus one percentage point (CPI-1) for life with a one-time restoral. Restoral is defined as recomputing retirement pay at that point assuming full CPI had been in effect. Disability retirees and survivors receive full CPI protection.

The following major considerations guided the development of these options:

- Any revision to the military retirement system will apply only to those entering after the enactment of the revision.

- The Services must maintain a youthful and vigorous force relative to the labor force of society as a whole or the civil service labor force for that matter.

- The initial retirement eligibility point of 20 years of service should be maintained both to provide the youthful and vigorous force and to provide the necessary career incentive for those serving in the relatively greater arduous duty locations.

- The multipliers (percent of basic pay per year of service) are the most visible aspects of any revision.

- The revision should provide an incentive for all to serve 20 years of service, yet encourage members to remain on active duty past 20 years of service.

- The requirements of a youthful and vigorous force as implemented by the Defense Officer Personnel Management Act and Service policies result in the forced retirement of Service members from the military. Thus, the duration of retirement from the military is longer, and without restoral a reduced COLA would unduly lower the real value of retired pay in old age.

SECTION 3

IMPACT OF REDUCING RETIREMENT BENEFITS TO ACHIEVE A $2.9B SAVINGS IN FY 86

There are several quantitative ways to view the impact of the two options submitted and they will be presented in this section.

First, the reduction of $2.9B in FY 86 retirement accrual payments equates to a reduction of 16 percent--original figure for FY 86 was $18.2B. As the actuarial method for FY 86 involved costing the accrual payment based on the retirement benefit available for individuals entering the armed forces in FY 86, the reduction translates directly to a 16 percent reduction in retirement benefits for such individuals. This reduction in benefits is independent of the option selected--the two submitted or any others developed that also would save $2.9B. Further, this reduction is an addition to the 13 percent reduction on high-3--implemented in 1980 for all new entrants. It is intuitively obvious that an additional 16 percent reduction in future retirement benefits will be a disincentive for reenlistment and to a lesser degree for initial enlistment. Surveys conducted by the armed forces at reenlistment have repeatedly found that the military retirement system is the single greatest factor influencing decisions to reenlist. An additional 16 percent reduction in benefits could significantly degrade the Department of Defense's ability to maintain the personnel required for combat readiness.

A second view of the impact of such change is to look at the degradation of initial retirement pay. Table 1 displays the initial percentage of final basic pay that typical retirees receive currently upon retirement, that those entering since September 1980 who are under high-3 will receive, and what would be received under the two options. Whereas the current retiree receives from 50 percent to 75 percent of basic pay depending upon years of service, even without further change to the military retirement system this range will be reduced to from 45 percent to 69 percent for Service members entering since 1980. The options would further reduce retirement pay to 36 percent of basic pay for the 20-year retiree under the structural-only option, and 40 percent under the combination option.

As retirement pay is calculated on the basis of a portion of total pay, basic pay only, Table 2 provides information similar to Table 1 but shows initial retirement pay as a percentage of final total pay, excluding special pays such as aviator continuation incentive pay, sea pay, etc. The special pays have been excluded as they vary significantly for individuals; however, if included the percentages in Table 2 would be lower. This Table

dispels the myth that a Service member retires at half pay after 20 years of service. Those retiring today receive only 34 percent of final pay, and the younger Service members will receive only 31 percent of final pay after 20 YOS. Under the structure-only option, the 20-year retiree would receive 25 percent of final pay and those serving 30 years or more would receive only 46 percent of final pay. For the combination option, the percentages of final pay would be 27 for 20 years and 50 for 30 years or more.

Next, the impact on individual retired pay over time is exhibited in Figures 1 and 2. Monthly retired pay is displayed for typical officer and enlisted retirees currently retiring, for those who entered after September 1980 and will retire under high-3, and for the two options. The initial retired pay shows the effect of high-5 combined with the multiplier reduction for that alternative. The value of retired pay with respect to inflation or real retired pay over time for the retirees is displayed to capture the effect of the COLA reduction. As previously stated, both options reduce current benefits by 16 percent. As Figures 1 and 2 reveal, the combination option provides relatively more retired pay initially and less retired pay prior to restoral at the 40th anniversary, more retirement pay following restoral and less in old age due to the COLA reduction. The typical enlisted retiree initially would receive $941 per month currently, $813 under high-3, $684 per month under the structure-only option and $743 per month under the combination option. Whereas the real monthly retired pay would be maintained for the structure-only option, it would decrease to $623 at age 75 under the combination option. Without the absolutely necessary restoral feature, the effect of a continuous CPI-1 would reduce the real value of retired pay to $522 at age 75. Given the nature of a military career as previously discussed, the High-3 system which applies to Service members who entered since 1980 provides only $813 per month to the typical enlisted retiree and $1838 per month to the typical officer retiree is far from "lavish" and is considered the minimum amount necessary to provide the incentive for young Americans to opt for a career in the armed forces, anticipating periods of war as well as peace.

Finally, Tables 3 through 6 display the impact of the options on recruiting and retention. These tables were formulated using the recruiting and retention model developed for use by the recently completed Fifth Quadrennial Review of Military Compensation. As can be seen, the impact of both options is similar. It should be noted that, as directed by the Authorization Language, the tables shown in this report were generated using retention data from the 1976-82 time period (i.e., the final Fifth QRMC data). Current retention behavior has improved over the levels experienced then. If we were to assume that current retention rates are the best estimates of retention in the long run, then the effect on the career force would be less than projected compared to today's force, but the relative effects would be about the same.

Assuming today's total force size, Tables 3 through 6 display the change in force size at various experience levels (years of service) resulting from a change in retention and the concomitant increase in accessions required to sustain the force size. The resultant force projected for the options is a steady-state force. In other words, it is the force that would result in the long run, after the effect of the change to the military retirement system had stabilized.

The effect of the options is shown first relative to today's force (7-year average) which includes a career force whose retention decisions were based on a retirement system wherein retired pay is calculated based on terminal pay, i.e., not high-3. Then the projected impact of high-3, which will affect all Service members entering since September 7, 1980, and the impact of the options relative to it are displayed.

Relative to today's force (Tables 3 and 5), the options would significantly reduce the experience level of the enlisted force as can be seen by the reduction of 38 to 39 thousand Service members in the 11-20 year group and 19 to 20 thousand Service members in the 21-30 year group. Such a hemorrhage of experience--approximately 12 percent of the mid-grade force and 35 percent of the senior force--would significantly reduce combat readiness. The complexity of warfare today and in the future exacerbates the degradation in combat readiness which would result from the loss of experienced officers, non-commissioned officers and petty officers. This degradation in combat readiness would be the direct result of a loss in leadership capability and overall technical expertise. Even a sizable increase in training funds for careerists could not totally alleviate the problem. Concomitantly, the options would increase the number of accessions required by 20 thousand. Given the improving economy and in particular the reduced unemployment rate, this would place a significant burden on our recruiting force. In FY 86 the Department of Defense will spend approximately $1.5B on recruiting. Given the degradation in the military retirement system incentive, recruiting costs would most likely exceed the 6 percent or $90M in FY 86 dollars indicated by a proportional increase. Likewise, recruit training costs would increase as would other first-term training costs and permanent change of station and temporary duty costs.

The impact of high-3 for those entering since September 1980 has not had time to materialize as few have faced the first reenlistment decision and none have reached the subsequent reenlistment decisions which shape the force. Nevertheless, the options are presented relative to high-3 as well. As can be seen in Tables 4 and 6, the impact of the options relative to high-3 is similar but not as great. The exception is that while fewer Service members would opt for a military career (reduction in the 11- to 20-year group) more of those who remained for 20 YOS would choose to remain longer.

The effect on recruiting and retention shown in Tables 3 through 6 is the output of the modified Annualized Cost of Leaving (ACOL) model used by the 5th Quadrennial Review of Military Compensation. While this model takes into account the direct effect of a reduction in retirement benefits, it does not take into account the change in propensity to serve in the armed forces resulting from a perception that such a reduction by the Congress is indicative of the nation's placing less value on such service. Such a perception would exacerbate the impact on retention and recruiting.

In the final analysis, the impact of a change to the military retirement system required to reduce accrual costs by $2.9B in FY 86 would

- reduce individual retirement benefits an average of 16 percent and could

- significantly decrease the career content, experience level, leadership capability and technical expertise of the armed forces

- increase required accessions, recruiting costs, training costs and permanent change of station costs

- significantly degrade the combat readiness of the armed forces and the Department of Defense's ability to meet national security objectives.

TABLE 1

Initial Military Retired Pay As A Percentage of Final Basic Pay *

Years of Service At Retirement	Option			
	Current	Hi-Three	Structure Only	Combination
20	50.0%	45.3%	36.3%	39.8%
21	52.5	48.1	39.5	43.2
22	55.0	47.6	40.0	43.4
23	57.5	51.1	43.5	47.3
24	60.0	54.4	46.9	51.2
25	62.5	57.8	50.3	55.0
26	65.0	53.6	47.9	51.6
27	67.5	58.1	52.3	56.6
28	70.0	62.6	56.3	61.6
29	72.5	67.1	60.2	66.5
30	75.0	69.3	64.3	69.3

* The effect of averaging basic pay in computing initial retired pay varies by paygrade. Figures shown are for grade E-7.

The computation of percentages are based on the following: Current-based on final basic pay and applies to members who entered service prior to September 8, 1980; Hi-Three-based on average of high three basic pay and applies to members who entered service on or after September 8, 1980; Structure Only-based on average of high five basic pay; Combination-based on average of high three basic pay.

Computation of basic pay assumes a 6.2% pay growth and accounts for longevity increases but not for promotions. Excluding promotions understates the effect of averaging basic pay to compute initial retired pay.

TABLE 2

Initial Military Retired Pay As A Percentage of Final Total Pay *

Years of Service At Retirement	Option			
	Current	Hi-Three	Structure Only	Combination
20	34.3%	31.1%	24.9%	27.3%
21	36.0	33.0	27.2	29.6
22	38.4	33.2	27.9	30.3
23	40.1	35.6	30.4	33.0
24	41.9	38.0	32.7	35.7
25	43.6	40.3	35.1	38.3
26	46.6	38.4	34.3	37.0
27	48.4	41.7	37.5	40.5
28	50.2	44.9	40.3	44.1
29	52.0	48.0	43.2	47.7
30	53.8	49.7	46.1	49.7

* The effect of averaging basic pay in computing initial retired pay varies by paygrade. Figures shown are for grade E-7.

The computation of percentages are based on the following: Current-based on final basic pay and applies to members who entered service prior to September 8, 1980; Hi-Three-based on average of high three basic pay and applies to members who entered service on or after September 8, 1980; Structure Only--based on average of high five basic pay; Combination-based on average of high three basic pay.

Computation of basic pay assumes 6.2% pay growth and accounts for longevity increases but not for promotions. Excluding promotions understates the effect of averaging basic pay to compute initial retired pay.

FIGURE 1

ENLISTED

MONTHLY RETIRED PAY - 1985 DOLLARS

ALTERNATIVE SYSTEMS E-7 W/22 YOS

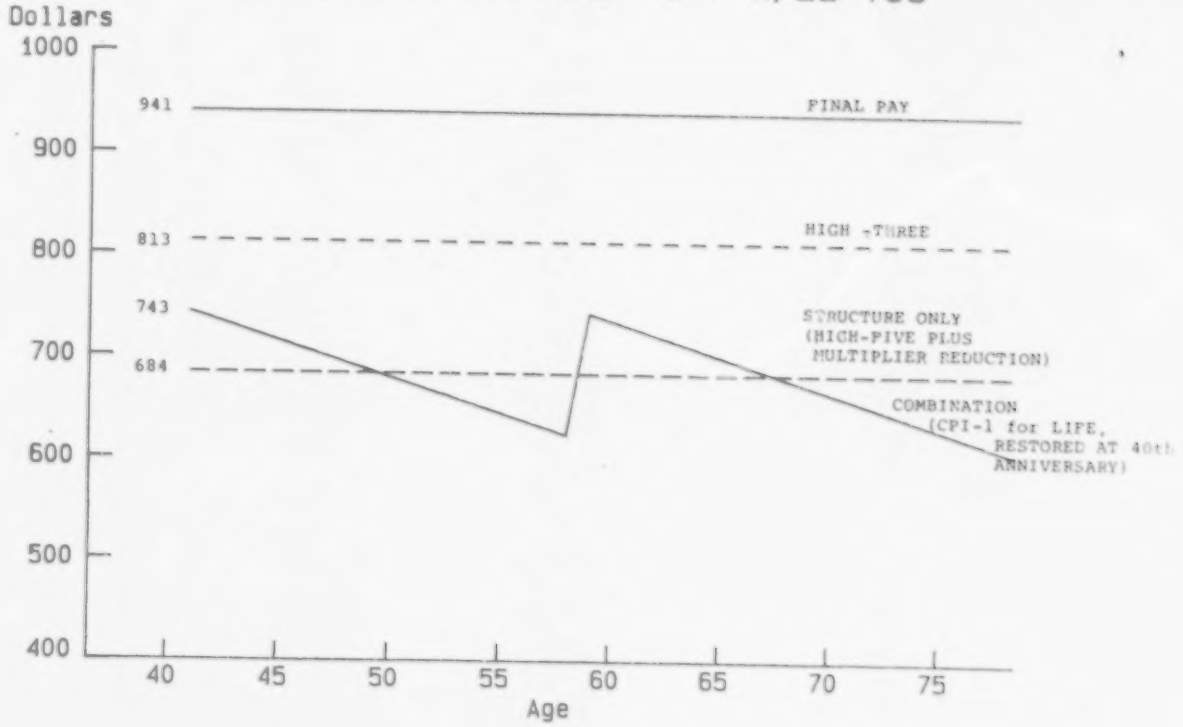


FIGURE 2

OFFICER

MONTHLY RETIRED PAY - 1985 DOLLARS

ALTERNATIVE SYSTEMS 0-5 W/23 YOS

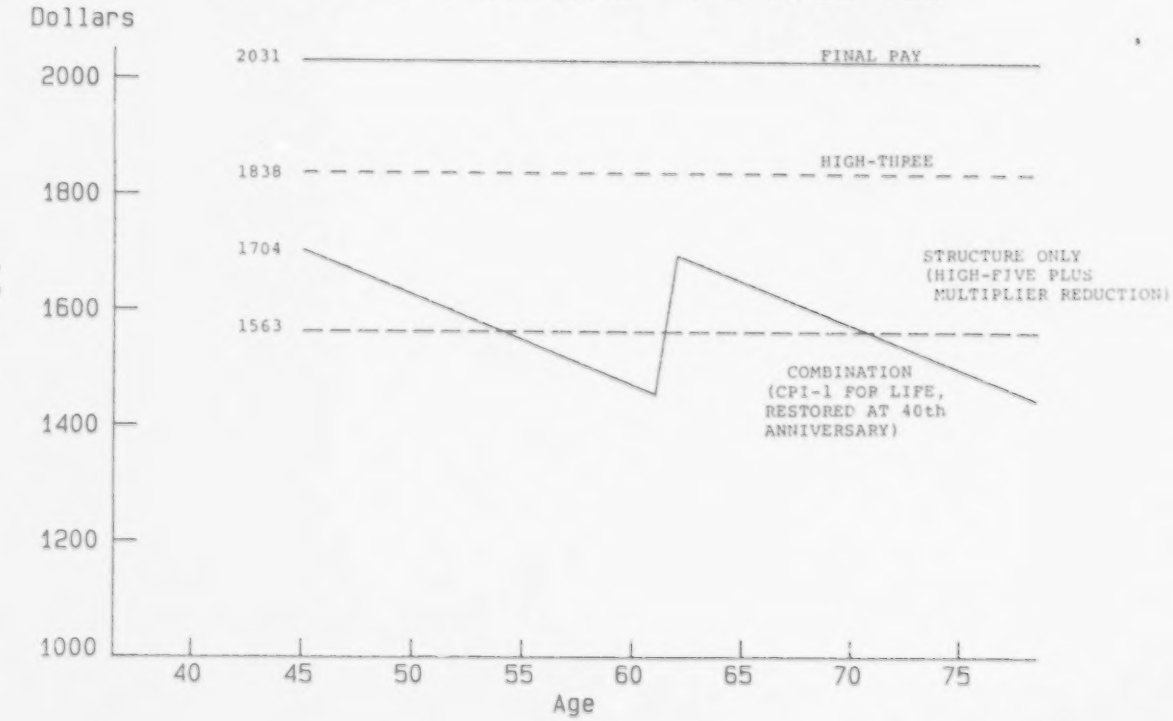


TABLE I

IMPACT RELATIVE TO TODAY'S FORCE

ENLISTED

	TODAY'S 7-YR AVG	STRUCTURE-ONLY OPTION	COMBINATION OPTION
ACCESSIONS	332,548	352,895	352,743
DIFF		20347	20195
%CHANGE		6.1	6.1
(YOS) 1-4	1,030,730	1,091,797	1,091,423
DIFF		61067	60693
%CHANGE		5.9	5.9
(YOS) 5-10	389,129	386,499	386,647
DIFF		-2630	-2482
%CHANGE		-0.7	-0.6
(YOS) 11-20	329,617	291,468	290,358
DIFF		-38149	-39259
%CHANGE		-11.6	-11.9
(YOS) 21-30+	55,262	34,977	36,310
DIFF		-20285	-18952
%CHANGE		-36.7	-34.3
(YOS) 5-20	718,746	677,967	677,005
DIFF		-40779	-41741
%CHANGE		-5.7	-5.8
(YOS) 5-30+	774,008	713,944	713,315
DIFF		-60064	-60693
%CHANGE		-7.8	-7.8

TABLE 3-

IMPACT RELATIVE TO FORCE
WITH 120kt OVERBOOKING

ENLISTED

	TODAY'S 7-YR AVG	FUTURE NO-D	STRUCTURE-ONLY OPTIONS	COMBINATION OPTIONS
ACCESSIONS	320,548	340,315	352,895	352,740
DIFF			12580	12425
%CHANGE			3.7	3.7
(YOS) 1-4	1,029,770	1,054,389	1,091,797	1,091,427
DIFF			37408	37038
%CHANGE			3.5	3.5
(YOS) 5-10	289,129	290,098	286,499	286,247
DIFF			-3599	-3851
%CHANGE			-1.2	-1.3
(YOS) 11-20	329,617	320,978	291,468	290,958
DIFF			-29510	-30020
%CHANGE			-9.2	-9.5
(YOS) 21-30+	55,262	39,061	34,977	36,314
DIFF			-4084	-2731
%CHANGE			-10.5	-7.0
(YOS) 5-20	718,746	711,286	677,967	677,005
DIFF			-33319	-34281
%CHANGE			-4.7	-4.8
(YOS) 5-30+	774,008	750,347	712,944	713,319
DIFF			-37403	-37028
%CHANGE			-5.0	-4.9

TABLE 5

IMPACT RELATIVE TO TODAY'S FORCE

OFFICERS

	TODAY'S 7-YR AVG	STRUCTURE-ONLY OPTION	COMBINATION OPTION
ACCESSIONS	29,775	27,738	27,852
DIFF		-2037	-1923
%CHANGE		-6.8	-6.5
YOS 1-4	93,764	100,532	100,848
DIFF		6768	7084
%CHANGE		7.2	7.6
YOS 5-10	81,398	83,416	83,305
DIFF		2018	1907
%CHANGE		2.5	2.3
YOS 11-20	73,772	67,977	67,870
DIFF		-5795	-5902
%CHANGE		-7.9	-8.0
YOS 21-30+	20,967	17,878	17,694
DIFF		-3089	-3273
%CHANGE		-14.7	-15.6
YOS 5-20	155,170	151,393	151,175
DIFF		-3777	-3995
%CHANGE		-2.4	-2.6
YOS 5-30+	176,137	169,271	169,049
DIFF		-6866	-7088
%CHANGE		-3.9	-4.0

[illegible]

[illegible]

[illegible]

	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	25,775	21,672	27,738	27,852
DIFF			1216	1230
%CHANGE			4.6	4.8
[illegible]	92,784	96,427	100,632	100,843
DIFF			4195	4411
%CHANGE			4.3	4.6
[illegible]	81,398	82,119	87,416	87,815
DIFF			1212	1771
%CHANGE			1.5	1.7
[illegible]	72,772	72,447	67,977	67,870
DIFF			-4470	-4577
%CHANGE			-6.2	-6.3
[illegible]	20,967	18,912	17,878	17,674
DIFF			-1034	-1238
%CHANGE			-5.5	-6.5
[illegible]	155,170	154,581	151,393	151,379
DIFF			-3188	-3186
%CHANGE			-2.0	-2.1
[illegible]	176,127	173,473	169,271	169,049
DIFF			-4202	-4424
%CHANGE			-2.4	-2.5

SECTION 4

IMPLEMENTATION PLAN

The Authorization Bill further requests DoD to submit a plan for implementing the options submitted over a four-year period. If the military retirement system is to be degraded in spite of the DoD's objections, the Department requests the change be implemented in full rather than over a four-year period for the following reasons:

(1) The options to the retirement system must reduce the accrual funding to the military retirement fund by $2.9B in FY 86. Thus, that portion of any total change which is implemented in FY 86 must save $2.9B in that year. Any portion of the total change deferred for implementation in the next three years would increase the total degradation of the military retirement system beyond that contained in the options submitted.

(2) The retirement benefit for today's Service members who entered before September 7, 1980, is based on final pay. For those entering after that date, it is based on highest 36 months (High-3). A change to the system will introduce a third class of Service members with respect to retirement pay. Such is far from desirable but definitely preferable to not grandfathering individuals who entered the service and chose to remain under a previous retirement system. However, a four-year phased implementation of either option submitted would create unnecessary additional classes which would be unacceptable.

SECTION 5

OFFSETS FOR FURTHER DEGRADATION OF THE MILITARY RETIREMENT SYSTEM

The accrual reduction of each option as determined by the DoD Actuary was calculated employing the methods and economic assumptions used to submit the accrual funding requirement in the President's budget. As such, the $2.9B reduction is determined by changing the retirement benefits and then applying those benefits to the force structure used to calculate the accrual payment for FY 86. In other words, the benefit is changed and the accrual reduction is determined based upon recent retention rates and today's force size. If the significant degradation to the career force projected actually occurs, the accrual reductions are substantially underestimated. On the other hand, one can argue that the nation will not degrade its national security and additional funding in the form of pay, bonuses and training will be appropriated to offset the change to the retirement system. If so, the reduction to retirement accrual is not overstated, but the net projected reduction to the DoD budget will be significantly less. As an aside, the accrual reduction decreases the DoD budget but has no effect on overall federal outlays nor the deficit for approximately 20 years.

Projecting the amount of funding and its form, i.e., pay raises, bonuses, etc., that would be required to offset the lower retention resulting from reducing the retirement element of compensation is difficult, to say the least. For example, high-3 was implemented in 1980 for new entrants at a time of extremely low retention resulting from successive pay caps. The pay raises and other compensation initiatives (e.g., the variable housing allowance) authorized and appropriated by the Congress in 1980 and 1981 resulted in significantly improved retention and most likely mitigated the potential initial impact of high-3. Furthermore, surveys and analyses reveal that while the retirement system is a major incentive for the first reenlistment decision, it becomes an even more significant factor affecting reenlistment decisions of Service members with eight to ten years of service and thereafter. As high-3 affects only those entering in the last five years, insufficient time has passed to determine the compensation changes that will be required to offset this 1980 change to the military retirement system. These facts significantly hamper the Department's ability to project the increases to compensation that would be required to offset further change.

Nevertheless, the following Congressional actions would be prudent if the military retirement system is again changed to further reduce military retired pay and the retention incentive of the system.

- Ensure military pay remains fair, competitive and comparable with pay in the private sector,

- Quickly respond to requests to increase bonus levels and total bonus funding,

o Fully fund requests to increase non-pay components of compensation such as medical and dental care for dependents, military housing, permanent change of station allowances and other elements affecting the Service member and the military family,

o Be receptive to the necessity either to overturn the change implemented or to consider and test other alternatives that may be proposed by the Department, such as lump-sum payments or an Individual Career Investment account.

SECTION 6

EVALUATION OF SPECIFIED LEVELS OF REDUCTION IN RETIREMENT ACCRUAL FUNDING

The Defense Authorization Act for FY 86 further requested an evaluation of the effects of reducing the retired accrual payment by $1.8B, $2.9B, $3.6B, $4.0B, and $5.4B in FY 86. Specific options for the four other levels were not developed. However, the relative impact of these changes can be captured by assessing the effects of structural-only alternatives, which include high-5 and reduced multipliers, rounded to the nearest tenth of a percent. These alternatives are:

Reduction ($B)	Pay Basis	Multiplier (%)	
		Years 1-20	Years 21-30
1.8	High-5	2.4	2.7
2.9	High-5	2.15	3.2
3.6	High-5	2.0	3.5
4.0	High-5	1.9	3.7
5.4	High-5	1.6	4.3

The effect of the alternatives will be presented in a manner similar to that presented for the two options. First, each of the five levels can be translated directly into a percentage reduction in retirement benefits. The $1.8B reduction is a 10 percent reduction in retirement benefits, whereas $2.9B reduces it 16 percent, $3.6B reduces it 20 percent, $4.0B reduces it 22 percent, and $5.4B reduces it 30 percent. The greater the reduction in retirement benefits, the greater the negative effect on retention and recruiting, though for technical reasons discussed below this relationship is not proportional.

Again, the effect of these five levels can be viewed by looking at the degradation of initial retirement pay as a percentage of final basic pay (Table 7) and as a percentage of total pay (Table 8). The previously discussed caveats for total pay apply. Without further reduction of military retired pay, new entrants in FY 86 would receive 45 percent of final basic pay and 31 percent of final total pay when retiring after 20 years of service. The percentages for 30 years of service would be 69 percent and 50 percent, respectively. The figures for retirement pay as a percentage of total pay are overestimated in that they do not account for the effect high-5 averaging has on pay due to promotions during the last five years of service, nor do they include special pays. Nevertheless, 31 percent of final pay for 20 years' service and 50 percent for 30 years' service is not lavish. In fact, the Department of Defense is concerned that such percentages may be insufficient to provide the necessary career incentive in the 1990s to those who entered service after 1980. The alternative levels of accrual reduction would further reduce retirement pay. As can be seen in Table 8, at the extreme

case of a $5.4B reduction, retired pay as a percentage of total pay would be reduced to 18 percent for 20 years of service and 46 percent tor 30 years of service, virtually eliminating retired pay as a career incentive.

The effect on retired pay for typical enlisted and officer retirees is shown in Figures 3 and 4. In all cases--today's retirees, high-3 retirees and the five levels of reduction under high-5--retired pay is assumed to be fully protected against inflation. Current retired pay levels will be reduced significantly by the effect of high-3 when Service members who entered since 1980 retire. Thus, the retired pay for the typical enlisted retiree who entered service in FY 86 will be only $813 per month (Figure 3). For the typical officer, the figure for 23 years' service will be $1838 per month (Figure 4). The alternative levels of accrual reduction would further reduce these figures. At the $5.4B level, the typical enlisted would receive $562 per month and the officer $1335 per month. Thus, further reduction of military retired pay will unduly decrease the effect of the military retirement system as a career incentive and undercompensate Americans who choose to serve their country as careerists in times of both peace and war.

Finally, Tables 9 through 12 display the impact on retention and recruiting for the five levels of retirement accrual reduction using the ACOL model developed by the 5th Quadrennial Review of Military Compensation. Again, the impact is shown for enlisted personnel and for officers, first in relation to Service members retiring today (Tables 9 and 11) and then in relation to high-3 retirees, those who entered since 1980 (Tables 10 and 12). As one would expect, the reduction in numbers of mid-grade officers, non-commissioned officers and petty officers increases progressively as the level of accrual reduction increases. The loss of mid-grade enlisted personnel ranges from 8 percent to 16 percent compared to today's force and from 5 percent to 14 percent compared to the projected high-3 force. The losses are similar for mid-grade officers. In contrast, the number of officers and enlisted personnel progressively increases in absolute terms for the 20-30+ year groups. Nevertheless, there is significant loss of senior personnel. For the senior enlisted leadership, the loss ranges from 42 percent to 20 percent with respect to today's force. For senior officers, the range of losses is from 18 percent to 9 percent for today's force. The losses are similar for both senior enlisted personnel and senior officers with respect to the projected high-3 force, with one exception. The gain shown for the $5.4B level results from the characteristics of the model that will be discussed in subsequent paragraphs and from the fact that the model is unconstrained by Congressionally imposed grade limitations for officers and senior enlisted personnel (E-8/E-9). The net result is a progressive decrease in available leadership capability and technical expertise, and increased accessions, recruiting costs, first-term training costs and permanent change of station costs.

Inspection of Table 9 and Table 11 reveals that there is not a direct, proportional relationship between the actuarial estimates of accrual cost savings from a change in the retirement system, and the impact that change has on force manning. A change in the system that saves $1.8B, for example, reduces the size of the enlisted career force (YOS 5-30+) by 6 percent and the size of the officer force by 3 percent, relative to today's force. However, moving from a system which the actuary estimates will save $4.0B to one that saves $5.4B, an increase in accrual savings of $1.4B, has a negligible impact on enlisted and officer force manning, as measured by the number of members with five or more years of service.

The reason for the absence of a direct relationship between accrual cost savings and force impact is a fundamental difference between the assumptions required for the actuarial model generating the accrual estimates and the way the retention effects are modeled in the Annualized Cost of Leaving (ACOL) model. The estimates of accrual cost savings resulting from a change in the retirement system assume that retention rates, and therefore numbers of people leaving at each year of service, are unaffected by the change in the retirement system. The retention model, on the other hand, assumes that members adjust their retention behavior as their financial incentives change.

Consider, for example, the force impact of the alternative that saves $1.8B in accrual costs. The ACOL model predicts that retention rates prior to 20 years of service decline. However, individuals with less than 20 years of service will still look primarily to the 20-year retirement point in calculating the financial advantage of staying in military service. The incentive to remain beyond 20 years of service, once the 20-year point is achieved, increases, but only modestly. Now consider the effect on force manning from doubling the accrual savings (from $1.8B to $3.6B). Even with the effect of high-3 removed, as in Table 10, the additional impact is less than twice the impact of the original $1.8B cut in accrual. The reason for this is, primarily, the incentive to remain beyond 20 years of service, once the 20-year point has been reached, increases dramatically relative to the $1.8B reduction. Retention rates beyond the 20-year point increase, offsetting partially the decline in retention rates prior to 20 years of service.

When moving from the option that saves $3.6B in accrual costs to the one that saves $5.4B, the force manning impact is much less than could reasonably be inferred from the previous cases. There are two reasons for this. First, as in the previous instance, the incentive to remain in service beyond the 20-year point, once the 20-year point is reached, increases substantially. Hence, the increase in post-20-year of service retention rates offsets, partially, the decline in retention rates prior to 20 years of service. The second reason is related to how the ACOL model works. For a member at, say, the tenth year of service, the difference in the financial incentive to

stay when comparing the system implied by the $3.6B reduction in accrual costs to that of the $5.4B reduction, when the twentieth year of service is used as the "time horizon" for the calculation, is large. However, as one pushes this time horizon beyond the twentieth, the differential financial incentive becomes less and less, until it disappears at the thirtieth year of service. The ACOL model is constructed to search for the "horizon" which provides the greatest financial incentive to stay, for this is implicitly how an optimizing military member views the problem. In the last three levels of retirement change, the ACOL model is beginning to look at horizons beyond the 20-year point, for some reenlistment decisions before the twentieth year. Hence, the relative changes in the retention incentive of alternative retirement systems as computed by the ACOL model will not always be consistent with the relative changes in cost as computed by the actuarial model that employs assumptions and methods peculiar to actuarial science.

The models developed by the 5th Quadrennial Review of Military Compensation (5th QRMC) are good models, but this is not to say that they are uniquely the best. Models which project the effect of a major change of a magnitude that has not been observed in the past are extremely sensitive to assumptions. In this case, the projections of the effect of change to the retirement system on force structure are highly sensitive to discount rates which represent the individual's preference of pay over time and to continuation rates which incorporate the effect changes in benefits have on retention.

For example, the Army has developed its version of the ACOL model to project the impact of retirement changes which incorporates lower personal discount rates and higher elasticities. Some studies show that people decrease their retirement assets at an implicit discount rate which is very low. People value the certainty of retirement pay highly. This implies that the present value of retirement income could be larger than the 5th QRMC's estimate; and therefore people will be more sensitive to reductions in retirement.

The elasticities used in the 5th QRMC models were estimated from changes in reenlistment bonuses. These elasticities relate the effect that a temporary change in income will have on behavior. However, a change in retirement is a permanent change in income. One could expect much more significant effects from a permanent change. Further, the 5th QRMC estimates of elasticity were made using data collected when the current retirement system was in effect. A significant change in retirement could substantially alter the attractiveness of a military career. No one knows what continuation rates will be after a major change in retirement. Using elasticities estimated from temporary changes in income and continuation rates in effect under the current retirement system could produce an optimistic effect compared to what will occur if retirement benefits are reduced.

As a result of the change in the personal discount rate and continuation rates used, the Army version of the ACOL model predicts an impact on force retention up to twice that shown in Tables 9 through 12. Both are appropriate models based on reasonable but different assumptions. Given the magnitude of difference in the projections, the effect of the options on force structure as displayed using the 5th QRMC model may be optimistic; i.e., the degradation of the force and combat readiness may be far greater than projected. On the other hand, if the 5th QRMC model were run using current retention rates, the effect on the force compared to today's force would be less than projected.

In summary, the increasing levels of accrual reduction would in turn progressively decrease the career content of the armed forces, combat readiness, and the ability of the Department of Defense to satisfy national security requirements. None of the levels are considered prudent nor acceptable; however, of the five, the $1.8B reduction in accrual funding is least damaging. Thus, if the Congress intends to reduce military retired pay for future entrants in spite of the Department of Defense's objections and the projected degradation to national security, the Department would strongly prefer the $1.8B level over the others specified in the Defense Authorization Act.

Table 7

Military Retired Pay As A Percentage of Final Basic Pay *

Years of Service At Retirement	Option						
	Current	Hi-Three	1.8B	2.9B	3.6B	4.0B	5.4B
20	50.0%	45.3%	40.5%	36.3%	33.8%	32.1%	27.0%
21	52.5	48.1	43.4	39.5	37.2	35.7	31.1
22	55.0	47.6	43.3	40.0	38.1	36.8	32.9
23	57.5	51.1	46.4	43.5	41.8	40.6	37.1
24	60.0	54.4	49.4	46.9	45.4	44.4	41.3
25	62.5	57.8	52.5	50.3	49.0	48.2	45.6
26	65.0	53.6	49.4	47.9	47.0	46.4	44.5
27	67.5	58.1	53.5	52.3	51.5	51.1	49.6
28	70.0	62.6	57.1	56.3	55.8	55.4	54.4
29	72.5	67.1	60.7	60.2	60.0	59.8	59.3
30	75.0	69.3	64.3	64.3	64.3	64.3	64.3

* The effect of averaging basic pay in computing initial retired pay varies by paygrade. Figures shown are for grade E-7.

The computation of percentages are based on the following: Current-based on final basic pay and applies to members who entered service prior to September 8, 1980; Hi-Three-based on average of high three basic pay and applies to members who entered service on or after September 8, 1980; Structure Only-based on average of high five basic pay; Combination-based on average of high three basic pay.

Computation of basic pay assumes 6.2% pay growth and accounts for longevity increases but not for promotions. Excluding promotions understates the effect of averaging basic pay to compute initial retired pay.

Table 8

Military Retired Pay As A Percentage of Final Total Pay *

Years of Service At Retirement	Option						
	Current	Hi-Three	1.8B	2.9B	3.6B	4.0B	5.4B
20	34.3%	31.1%	27.8%	24.9%	23.2%	22.0%	18.5%
21	36.0	33.0	29.8	27.2	25.6	24.5	21.3
22	38.4	33.2	30.2	27.9	26.6	25.7	22.9
23	40.1	35.6	32.3	30.4	29.1	28.3	25.9
24	41.9	38.0	34.5	32.7	31.7	30.9	28.8
25	43.6	40.3	36.6	35.1	34.2	33.6	31.8
26	46.6	38.4	35.4	34.3	33.7	33.2	31.9
27	48.4	41.7	38.3	37.5	36.9	36.6	35.6
28	50.2	44.9	40.9	40.3	40.0	39.7	39.0
29	52.0	48.0	43.5	43.2	43.0	42.9	42.5
30	53.8	49.7	46.1	46.1	46.1	46.1	46.1

* The effect of averaging basic pay in computing initial retired pay varies by paygrade. Figures shown are for grade E-7.

The computation of percentages are based on the following: Current-based on final basic pay and applies to members who entered service prior to September 8, 1980; Hi-Three-based on average of high three basic pay and applies to members who entered service on or after September 8, 1980; Structure Only-based on average of high five basic pay; Combination-based on average of high three basic pay.

Computation of basic pay assumes 6.2% pay growth and accounts for longevity increases but not for promotions. Excluding promotions understates the effect of averaging basic pay to compute initial retired pay.

FIGURE 3

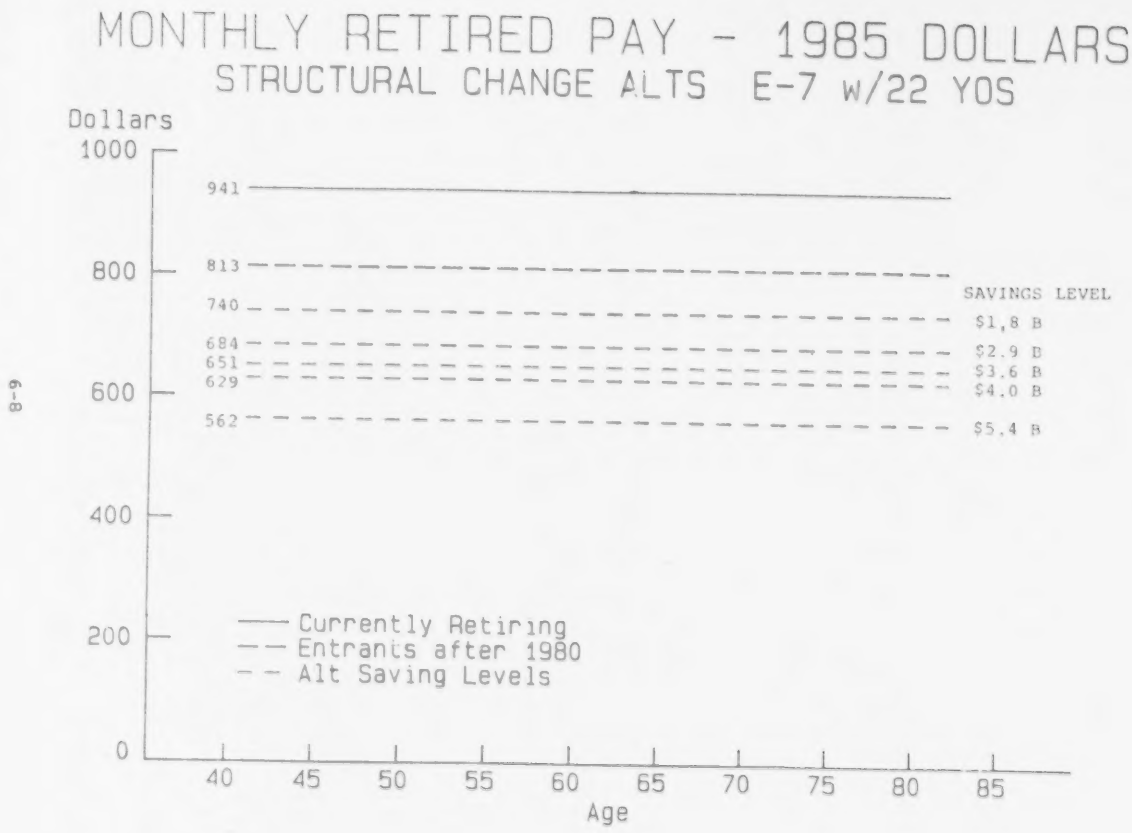
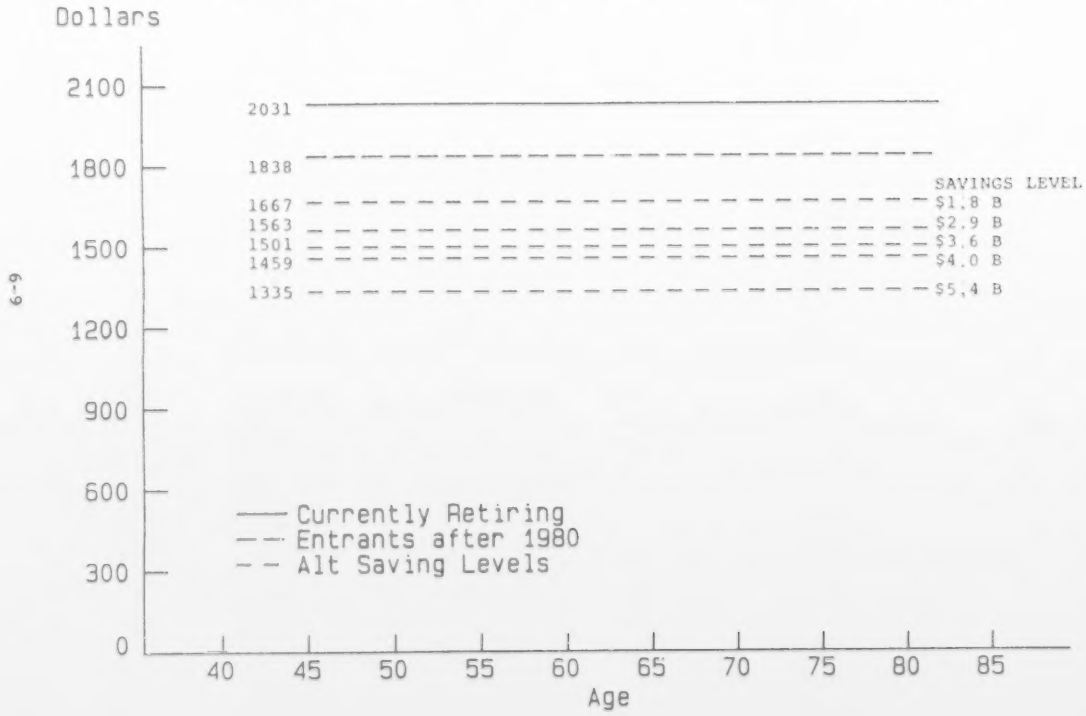

MONTHLY RETIRED PAY - 1985 DOLLARS
STRUCTURAL CHANGE ALTS E-7 w/22 YOS
Dollars
1000
800
600
400
200
0
941
813
740
684
651
629
562
SAVINGS LEVEL
$1,8 B
$2.9 B
$3.6 B
$4.0 B
$5.4 B
Currently Retiring
Entrants after 1980
Alt Saving Levels
40
45
50
55
60
65
70
75
80
85
Age

FIGURE 4

MONTHLY RETIRED PAY - 1985 DOLLARS

STRUCTURAL CHANGE ALTS O-5 w/23 YOS



6-9

TABLE 9

IMPACT RELATIVE TO TODAY'S TABLE

ENLISTED

	TODAY'S 7-YR AVG	OPTIONS FOR 1.8B REDUCTION	OPTIONS FOR 2.9B REDUCTION	OPTIONS FOR 3.6B REDUCTION	OPTIONS FOR 4.1B REDUCTION	OPTIONS FOR 3.4B REDUCTION
ACCESSIONS	332,548	348,960	350,895	354,172	354,627	354,914
DIFF		16412	18347	21624	22079	22366
%CHANGE		4.9	5.5	6.5	6.6	6.7
YOS 1-4	1,030,720	1,080,060	1,091,797	1,095,691	1,097,372	1,097,824
DIFF		49320	61057	64951	66652	67104
%CHANGE		4.8	5.9	6.3	6.4	6.5
YOS 5-10	387,129	388,142	386,499	386,445	386,626	386,618
DIFF		987	-630	-684	-503	-511
%CHANGE		0.3	-1.7	-1.7	-1.6	-1.6
YOS 11-20	329,617	304,700	291,468	285,478	282,709	278,377
DIFF		-24917	-38149	-44140	-46908	-51240
%CHANGE		-7.6	-11.6	-13.4	-14.2	-15.5
YOS 21-30+	55,162	21,821	14,477	12,184	10,699	10,463
DIFF		-33341	-40685	-42978	-44463	-44699
%CHANGE		-60.4	-73.7	-77.9	-80.6	-81.0
TOTAL	708,749	692,842	677,967	671,919	666,935	665,107
DIFF		-15914	-30779	-36827	-41811	-43639
%CHANGE		-2.2	-4.3	-5.2	-5.9	-6.2
TOTAL	774,113	754,917	741,984	738,149	737,634	737,570
DIFF		-19196	-32129	-35964	-36479	-36543
%CHANGE		-2.5	-4.2	-4.6	-4.7	-4.7

[illegible]

IMPACT RELATIVE TO TITLE
OPTIONS FOR SAVINGS

ENLISTED

	TOTAL S FY95 and	TITLE FY97	OPTIONS FOR 1.8B SAVINGS	OPTIONS FOR 2.9B SAVINGS	OPTIONS FOR 3.6B SAVINGS	OPTIONS FOR 4.3 SAVINGS	OPTIONS FOR 5.4B SAVINGS
ACCESSIONS	372,248	134,215	148,760	152,895	154,171	154,627	154,951
DIFF			8945	13081	14357	14812	14936
PCT CHANGE			2.5	3.7	4.1	4.2	4.7
YEAR 1-4	1,153,770	1,054,289	1,081,240	1,091,797	1,095,691	1,097,072	1,097,854
DIFF			26951	37418	41312	42694	43451
PCT CHANGE			2.4	3.5	3.9	4.1	4.1
YEAR 5-10	324,229	296,196	286,140	286,499	286,445	286,426	286,418
DIFF			-10056	-9697	-9751	-9770	-9778
PCT CHANGE			-3.4	-3.3	-3.3	-3.3	-3.3
YEAR 11-20	324,617	322,978	314,721	315,468	285,474	285,771	276,127
DIFF			-16278	-15531	-29524	-29227	-38871
PCT CHANGE			-5.1	-4.8	-11.1	-10.9	-12.9
YEAR 21-25	85,682	79,661	71,871	74,577	77,109	78,497	79,148
DIFF			-7720	-5084	-2451	-1062	-413
PCT CHANGE			-18.5	-12.2	-6.9	-3.9	-1.9
YEAR 26+	710,746	711,284	692,842	677,967	671,919	666,165	662,819
DIFF			-18444	-33319	-39367	-45120	-48471
PCT CHANGE			-2.6	-4.7	-5.5	-6.3	-6.8
YEAR 30+	710,746	711,284	692,842	677,967	671,919	666,165	662,819
DIFF			-18444	-33319	-39367	-45120	-48471
PCT CHANGE			-2.6	-4.7	-5.5	-6.3	-6.8
YEAR 31+	710,746	711,284	692,842	677,967	671,919	666,165	662,819
DIFF			-18444	-33319	-39367	-45120	-48471
PCT CHANGE			-2.6	-4.7	-5.5	-6.3	-6.8

TABLE II

IMPACT RELATIVE TO TOTAL 3 FORCE

OFFICERS

	TOTAL 3 FORCE AVG	OPTIONS FOR 1.6% REDUCTION	OPTIONS FOR 2.4% REDUCTION	OPTIONS FOR 3.2% REDUCTION	OPTIONS FOR 4.0% REDUCTION	OPTIONS FOR 4.8% REDUCTION
ACCESSIONS	25,775	27,510	27,766	27,960	27,955	28,196
DIFF		1735	1991	2185	2180	2421
%CHANGE		6.7	7.8	8.5	8.5	9.4
(YOS) 1-4	93,784	99,635	100,632	101,635	101,578	102,722
DIFF		5851	6848	7271	7471	7567
%CHANGE		6.2	7.3	7.8	8.0	8.5
(YOS) 5-10	81,298	82,687	83,416	83,670	83,616	84,126
DIFF		1389	2118	2372	2318	2828
%CHANGE		1.7	2.6	2.9	2.9	3.4
(YOS) 11-20	73,772	70,024	67,977	66,949	66,365	64,974
DIFF		-3748	-5795	-6823	-7407	-8798
%CHANGE		-5.1	-7.9	-9.2	-10.0	-12.0
(YOS) 21-30+	20,967	17,180	17,878	18,249	18,487	19,123
DIFF		-3787	-3089	-2718	-2480	-1844
%CHANGE		-18.1	-14.7	-13.0	-11.8	-8.8
(OS) 5-20	155,170	152,281	151,772	150,619	150,181	149,248
DIFF		-2889	-3398	-4551	-4989	-5922
%CHANGE		-1.9	-2.2	-2.9	-3.2	-3.8
(YOS) 5-30+	176,137	170,461	169,650	168,868	168,668	168,371
DIFF		-5676	-6487	-7269	-7469	-7766
%CHANGE		-3.2	-3.7	-4.1	-4.2	-4.4

ACCESSIONS	28,775	24,972	27,551	27,730	27,930	27,055	27,79
DIFF			578	1210	1378	1497	1024
%CHANGE			2.1	4.6	5.2	5.7	3.8
YOSI 2-4	32,764	36,477	39,625	40,572	41,025	41,075	41,72
DIFF			3198	4145	4598	4798	4274
%CHANGE			8.8	11.3	12.6	13.2	11.4
YOSI 5-10	31,378	32,114	30,107	32,415	32,670	32,816	34,1
DIFF			642	1950	1556	1702	2.5
%CHANGE			2.1	6.4	5.1	5.6	7.8
YOSI 11-20	72,772	72,447	70,624	67,977	66,949	66,765	64,774
DIFF			-2422	-4470	-5498	-5682	-7673
%CHANGE			-3.3	-6.2	-7.6	-8.4	-10.4
YOSI 21-30+	20,967	18,912	17,180	17,878	18,249	18,487	19,125
DIFF			-1732	-1034	-668	-425	213
%CHANGE			-9.2	-5.5	-3.5	-2.3	1.1
YOSI 5-20	155,179	154,561	150,181	151,293	150,619	151,181	154,4
DIFF			-4380	-2268	-2942	-4380	-749
%CHANGE			-2.8	-1.5	-1.9	-2.8	-0.5
YOSI 5-30+	176,127	173,472	167,306	169,171	168,868	169,668	174,5
DIFF			-6166	-4301	-4604	-3804	-1603
%CHANGE			-3.6	-2.5	-2.7	-2.2	-0.9

COMMITTEE ACTION

On April 16, 1986, the Committee on Armed Services agreed to report this bill by voice vote.

There were no roll call votes during the Committee's consideration of this legislation.

FISCAL DATA

CONGRESSIONAL BUDGET OFFICE ESTIMATE

In compliance with clause (1) of paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the estimate prepared by the Congressional Budget Office and submitted pursuant to section 403 of the Congressional Budget Act of 1974 is included below:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, April 23, 1986.

Hon. BARRY GOLDWATER,
Chairman, Committee on Armed Services,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: In response to your letter of April 21, the Congressional Budget Office has prepared the attached cost estimate for the Uniformed Services Retirement Cost Reduction Act of 1986, a bill to establish a revised retirement system for new members of the Uniformed Services, to revise the method of determining cost of living adjustments under the revised retirement system, and for other purposes.

If you wish further details on this cost estimate, we will be pleased to provide them.

Sincerely,

EDWARD GRAMLICH
(For Rudolph G. Penner).

CONGRESSIONAL BUDGET OFFICE—COST ESTIMATE

1. Bill number: Unassigned.

2. Bill title: The Uniformed Services Retirement Cost Reduction Act of 1986.

3. Bill status: As ordered reported by the Committee on Armed Services on April 16, 1986.

4. Bill purpose: This bill would establish a new retirement system for members first entering the Uniformed Services after the date of enactment. The new system would lower the percent of basic pay earned per year (the multiplier) for the first 20 years of service and raise it for years 20 through 30. In addition, cost of living adjustments for nondisability retirees would be permanently set at one percentage point less than the Consumer Price Index. At the fortieth anniversary of the service member's enlistment there would be a one time recomputation of retired pay as if full cost of living adjustments had been paid. Disabled retirees and survivors will continue to receive unreduced cost of living adjustments.

5. Estimated cost to the Federal Government:

[By fiscal year, in millions of dollars]

	1986	1987	1988	1989	1990	1991
Function 050:						
Estimated authorization	−1,199	−183	−466	−781	−1,088	−1,386
Estimated outlays	−1,196	−185	−465	−780	−1,088	−1,385
Function 600:						
Estimated authorization	−1,251	−305	−616	−978	−1,347	−1,717
Estimated outlays	0	0	0	0	0	0
Function 950:						
Estimated authorization	1,196	185	465	780	1,088	1,385
Estimated outlays	1,196	185	465	780	1,088	1,385
Net budgetary impact:						
Estimated authorization	−1,254	−303	−616	−979	−1,348	−1,718
Estimated outlays	0	0	0	0	0	0

Basis of estimate: Section 666 of the Department of Defense Authorization Act, 1986 (Public Law 99–145) limited the amount of money that could be obligated for basic pay and retired pay accrual for fiscal year 1986 in anticipation of changes in the military retirement system. In addition, section 667(a) required the Department of Defense (DoD) to submit a report containing two new retirement plans that would save $2.9 billion if enacted at the beginning of fiscal year 1986.

This bill adopts one of the DoD proposals, and repeals the limits in section 666. Both CBO and the DoD Retirement Board of Actuaries calculated that this plan represented a sixteen percent reduction in the entry-age normal cost percentage relative to new entrants to the Uniformed Services under current law. Sections 667(b) and 667(c) specified that if a significant change to the military retirement system was enacted during fiscal year 1986, the normal cost percentage would be recalculated and that the new normal cost percentage would be applied following the effective date of the legislation, which we assume to be May 1, 1986.

These sections also directed that the same methods used for computing the normal cost percentage in the fiscal 1986 budget request (50.7% of basic pay) should be used to calculate the new cost percentage. For fiscal year 1986, this means that the normal cost percentage for the entire force will be reduced sixteen percent for the remainder of the year, producing savings of $2.9 billion at an annual rate, but only $1.2 billion over the five months remaining in the year.

Beginning with fiscal year 1987, the actuaries will be calculating the normal cost percentage to be applied to all members of the military for budgeting purposes by weighting the separate cost percentages applied to members covered by each retirement system. Upon enactment of this bill there would be three such groups: those who entered the service before September 1980 and can retire after 20 years at 50 percent of their highest pay, those who entered the service between September 1980 and the date of enactment who can retire after 20 years at 50 percent of their highest 36 months of pay, and those who entered the service under the new plan who could retire after 20 years at 44 percent of their highest 36 months of pay. Under this procedure, savings in fiscal year 1986 would be less than $100 million.

In preparing this estimate, CBO estimated the proportion of the total basic pay covered by each of the three systems for fiscal years 1986 through 1991, given an enactment date of May 1, 1986. These weights were applied to the three separate normal cost percentages to produce an overall cost percentage to be applied to the entire force. Authorized end strength over the period covered by this estimate was assumed to be the same as current law. CBO baseline pay raises were used.

6. Estimated cost to State and local government: None.
7. Estimate comparison: None.
8. Previous CBO estimate: None.
9. Estimate prepared by: Michael McCord.
10. Estimate approved by: C.G. Nuckols for James L. Blum, Assistant Director for Budget Analysis.

Committee Cost Estimate

The Committee concurs in the Congressional Budget Office cost estimate.

Regulatory Impact

Paragraph 11(b) of rule XXVI of the Standing Rules of the Senate requires that a report of the regulatory impact of a bill be included in the report accompanying such bill. The Committee finds that in the case of this bill there is no regulatory impact.

Changes in Existing Law

Pursuant to the provisions of rule XXVI, paragraph 12 of the Standing Rules of the Senate, the changes in existing law made by the bill have not been shown in this section of the report since, in the opinion of the committee, it is necessary to dispense with showing such changes in existing law separately in the report in order to expedite the business of the Senate.

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